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The regulation of insider trading in corporate securities

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"THE REGULATION OF INSIDER TRADING ~~A COMPARATIVE ANALYSIS"~~ IN CORPORATE SECURITIES

BY

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"THE REGULATION OF INSIDER TRADING - A COMPARATIVE ANALYSIS"

Firstly it is necessary to examine insider trading in corporate securities in it's social and economic context.Before any discussion of substantive regulation can meaningfully take place it is necessary to consider such questions as the incidence of insider trading and whether in fact it causes harm.In particular the question of 'fairness' is considered,and the economic arguments sometimes raised in support of insider trading explored.

Corporate disclosure is directly related to insider trading.The ability of corporate insiders to abuse their positions is obviously related to the effectiveness of company disclosure. Furthermore,apart from the effect corporate disclosure has on the availability of information for investors,disclosure of insiders transactions may discourage abusive trading and assist in the enforcement of regulatory provisions.Disclosure may also be used as a sanction.The impact of expanded corporate disclosure policies and in particular the disclosure of price sensative information to employees is considered.

One of the main problems with anti-insider trading regulation is the satisfactory determination of a definition for insiders.This determination will set the scope of regulation.In drawing up this definition attention must be given to the problem of 'tippee trading' and the effect that such provisions might have on the securities industry.

An extensive study of the present law relevent to insider trading, in Britain,Australasia and Canada is provided with particular reference to the role of self regulatory authorities.Recent proposals for anti-insider trading legislation in the United Kingdom are analysed.

At the heart of any discussion of insider trading must be the question of enforcement .Civil enforcement is discussed in the context of derivative actions and class suits.The present structure of regulation

is analysed and a new enforcement agency is suggested.The crucial availability of effective market surveillance is discussed in the context of the experience of other countries.

"THE REGULATION OF INSIDER TRADING - A COMPARATIVE ANALYSIS"

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PREFACE

During the last decade British lawyers have become increasingly aware of the problems posed by the effectice legal regulation of insider trading in corporate securities,on the basis of privileged information.There is a long history of anti-insider trading regulation in the United States of America,and several Commonwealth countries have had legal inhibitions on insider dealing for almost twenty years.Many other countries outside the Commonwealth have adopted the anti-insider trading laws of the United States of America,in one form or another.In short there is a considerable amount of experience in this field to which British lawyers could make reference in attempting to deal with the problem in the United Kingdom.

The present author has attempted to discuss the question of insider trading in Britain in the context of extensive reference to the existing legal and self regulatory provisions.It is only by taking full account of the extra legal scheme of anti-insider trading regulation that anything approaching an informed view as to the present situation can be obtained.The associated topic of corporate disclosure,both on a continuous and also a timely basis must also be considered.Indeed it is often necessary to consider much wider aspects of securities regulation and general company law to obtain a fair picture of anti-insider trading regulation in any particular country.

Originally the present study comprehended an extensive discussion of insider trading regulation throughout the World.Given the necessity to reduce the dimensions of this thesis it was thought appropriate to exclude all such comparative accounts except those relating to Australia and Canada.In Chapter III a considerable amount of North American material has also been retained on the basis that in no other country has there been the same degree of experience in regulating insider trading by 'non-insiders' and 'tippees'.The materials omitted from this study are published elsewhere.(1)

No attempt has been made to make specific legislative recommendations with regard to the regulation of insider trading in Britain.It is probable that future legislation will be closely modelled on the

provisions of the 1973 Companies Bill.These provisions are extensively discussed in Chapter VIII,and the author has made submissions on this question to the Companies Policy Division of the Department of Trade.Furthermore it is likely that even greater attention will be given in the future to self regulatory proceedures designed to deal with insider trading and the abuse of confidential information.

The author would like to record his deep appreciation to his Supervisor,Professor A.J.Boyle of the University of London, for the great assistance given him during his course.It would not be appropriate in a work of this nature to express one's appreciation to other individuals.It is sufficient to state that without the full cooperation and provision of information sometimes of a confidential nature,to the author,by a large number pf persons,in this country and abroad,this study would not have been possible.The author would also like to express his appreciation to a number of overseas universities for making their facilities available to him,and inparticular to Harvard Law School, the University of Toronto, the University of New South Wales and Atenao Law School,Philippines.

The law is as stated on April 1st 1977.

1st August 1977
Jesus College,
Cambridge.

Barry A.K.Rider,
Fellow of Jesus College.

CHAPTER I

INSIDER TRADING, SOME INITIAL CONSIDERATIONS.

by Rev.R.C.Baumhart,[1] of some 1700 executives, found that whilst in possession of material inside information,

42% would buy for themselves,
2% would tell a broker,
14% would tell a friend,
56% would do nothing.

But perhaps more interestingly, when the sample was asked what they thought other executives would do,

61% would buy for themselves,
11% would tell a broker,
46% would tell a friend,
29% would do nothing.

A similar survey was carried out in Britain, by Simon Webley, in 1971,[2] the response from 830 managers was,

24% would buy for themselves,
0.9% would tell a broker,
2% would tell a friend
65.4% would do nothing
7.7% don't know.

Simon Webley thought that the reason why one in four managers said they would trade on inside information reflected the fact that not all of them were or would be directors, and because of their character would not be given access to such information. Only 12.5% of the sample thought that directors would utilise such information. A survey conducted by Business Administration, in April 1976, found that out of a sample of 150 managing directors of British companies, 20% had been offered bribes, and the same proportion thought that other directors accepted such.[3] It would thus appear probable that the degree of insider trading likely to take place is of a significant proportion. It is thus legitimately a matter of concern.

The next question which must be answered, is that even accepting that the incidence of insider trading is significant or likely to be such should it be discouraged. In short is the incidence of such conduct acceptable? It would seem that in the past, there have been cases of insider trading, which were either ignored or criticised on some other ground, the inference being that insider trading was not then necessarily considered objectionable.[4] It is possible however to find early statements where it has been condemned on moral grounds. For example the Commercial and

Financial Chronicle for the 8th February 1872, described it as 'a very great evil'. Indeed, Winston Churchill thought that the suggestion by the editor of the Financial News that he had acquired securities in Marconi on the basis of privileged information was 'downright insulting and libellous'.

It would seem that the great preponderence of opinion today, at least in Britain is that insider trading is unethical, or immoral. It is probable however, that this view is more strongly held by those outside the business world than those inside it. There is weight in the observation that most ordinary citizens, once acquainted with what insider trading is, would simply consider it to be unfair.(5) It would certainly be wrong for the law to ignore this.(6) It is also true that when lawyers have sought to argue that insider trading is wrong and should be prevented they too have placed weight on the unfairness aspect. The insider should not be able to take advantage of his position over an outsider to derive an extra advantage. This is slightly different than saying there should be equality in a substantive way, although might equate to an equality of bargaining. The difficulty, of determining whether insider trading is acceptable is thus transferred to the justification of the principle of equality of opportunity. No attempt will here be made to justify this principle, as essentially its acceptance will be determined by an a priori value judgement of the assessor. However, it would seem from empirical analysis that the principle of equality of bargaining and thus opportunity within a market context can and has been legitimately accepted by courts as a basis for determination. It must be emphasised that adherence to this concept only requires that the parties start equally, and derive no advantage from a superior privilege possessed by the one and denied to the other. Of course given different financial, educational, intellectual and analytical abilities there is no attempt to attain substantive equality. The fundamental difficulty lays in knowing or determining where the line between acceptable unfairness and unacceptable unfairness should be drawn. It is said by many that the insiders advantage is illegitimate as he did not acquire his privileged knowledge through any intrinsic merit in

himself. This ignores the fact that his insider position was probably acquired in the first place by industry. Furthermore, the same economic structure that has placed the insider in the position of ascendency will also allow him other financial privileges in most cases, which are not dubbed unfair, indeed can there ever be equality of opportunity on a market where one investor might be worth in excess of £500,000,000 as compared with another worth only a tiny fraction of such, Nevertheless, there is considerable support for the notion that insider trading is unfair and thus immoral.

The American House of Representatives' Committee on Interstate and Foreign Commerce, has been trenchantly criticised by at least one writer for engaging in a 'self-righteous' and hypocritical attack on insider trading.[7] The Committee had stated that,

> 'Among the most vicious practices unearthed...was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such...to aid them in their market activities'. (8)

Professor Manne considers that the American law has not properly taken account of the logical and economic aspects to insider trading. Whilst the statements of the Congressional Committees are admittedly emotive, there is logic in the equation of directors and officers to trustees and in regarding inside information as trust property.[9] The emotive attacks on insider trading do not belie the fact that the Congress was simply extending already recognised principles of fiduciary law. How far the underlaying equitable principles were as a matter of history a result of notions of fairness and good faith is irrelevent, as such are now recognised legal norms.[10]

The application of the fairness principle has been attacked on a number of grounds in the present context. It has rightly been pointed out that the law can never ensure complete equality of information, or indeed substantial equality.[11] In essence the discrepancies in information are one of the inherent risks that those who trade on the stock exchange must accept. Professor Manne seizes upon this point when he describes the securities market as essentially an exchange of information the market

placing relative values on particular types and qualities of information.(12) This neglects the fact that in certain instances the insider will be trading on information that the other party could not have obtained or used no matter what analytical capabilities he possessed.(13) Thus Manne is thrown back on his fundamental hypothesis that insider trading causes no one any identifiable harm. This again is misconceived and goes to economic justification and not fairness.

The main attack on the traditional American approach to insider trading by Manne is frontal, he asserts that the 'insiders gain is not made at the expense of anyone'.(14) Manne argues that trading by insiders is only a very small proportion of active trading, and in fact only a small proportion of outstanding securities are actively traded anyway. Where good information is concerned shareholders who retain their securities suffer no loss, and it is only those who sell just before the announcement who can be said to have suffered. Indeed insofar as the outsiders loss is the difference between the transaction price and that which would have been the price had the information been known, to the extent that insider trading results in the market price moving upwards the insider benefits selling outsiders by reducing their loss; according to Manne's thesis. Manne also distinguishes between those who trade because of market pressures and those whose transactions are dictated by external factors, such as the need to obtain liquid resources. In the latter case insider trading is said to be a direct benefit.

Where someone sells out before the full effect of the insiders trading is felt on the market, it can be equally said that the insider has caused loss to that person. Market traders, who deal on the basis of the market and not for personal or extraneous reasons can also be said to have suffered in that they would presumably not have traded, had they know what the insider had known. They in effect picked the wrong time to sell, but in logic it is hard to attribute responsibility for this error to the insider.(15) There is probably weight in Mannes argument with regard to loss, that

> 'It is simply not enough to say that it may on occasion happen. The truth is that for any individual with whom

> we are concerned, the absolute odds in favour of his losing anything as a result of insider trading are so small as to be unworthy of serious concern'. (16)

Manne does not really discuss the situation where an outsider acquires securities from an insider selling on bad information. Of course in a market context it is likely that the outsider is already in the market ready to trade at the market price, and if he had not traded with the insider he would have traded with someone else. In the case of a sale by an insider however, there is no room for Manne to argue that it is only the short term speculator who suffers, indeed he is likely to suffer the least in such a case.(17)

It has also been argued that insiders do not generally perform better than any other class of market trader, and thus whether they trade or not, on what they consider to be inside information in violation of their trust, the result in financial terms is the same. Whilst little empirical research has been conducted on this point, it would seem that there is evidence that insiders' performance in the market is superior to that of outside investors.(18) Thus although Manne is probably justified, at least in market transactions for attacking the concept of fairness from the standpoint of individuals suffering causally related loss, his arguments ignore the wider question of 'fairness'. That is whether an insider should be allowed to pass on a loss to another or take a profit, absent any compelling reason of public policy or morality justifying such. Certainly the law through the award of punitive or contemptuous damages has already indicated a concern for acknowledging questions of public policy in the context of individual suits.(19) Moreover, the criminal law, where public policy demands it, interfers on an apparent basis of 'fairness' such as in racial or sexual discrimination.

Professor Manne would argue that there are compelling reasons why insiders should be allowed to pass on loss and cream off profits, which displace the general norm of fair dealing. Perhaps the most 'astounding' suggestion, has been that insider trading is one of the rewards for entreprenural ability and a stimulus to the inventive

mind,(20) Manne the arch exponent of this view conceives of the entreprenure as distinct from mere managers or capitalists as the driving force behind a progressive economy. In the immediate context he considers the entreprenure as an innovator can be operative just as much in the world of finance as in manufacture. The prospect of large profits through share dealing, in effect backing himself, is the only form of compensation that is adequate to act as a stimulus to this kind of activity. As one might expect the criticisms that have been made of this view are legion. It is only necessary to cite the more obvious here. How is it possible in the modern corporation to identify the entreprenure, and how is it possible to devise a scheme of deliberate exploitation of confidential information for him. Indeed entreprenures are likely to have limited resources and are thus likely not to be able to maximise their 'legitimate' entitlement and in any case it does not follow that an entreprenure will have access to other information about the enterprise which might dictate an alternative course of conduct. Furthermore even if the prospect of such uncertain profits could be considered a sufficient inducement, surely Manne's argument could not be substantiated where the insider-entreprenure attempts to sell out when his innovations have failed. Of course Manne does take a much broader approach to the traditional view of insider trading and considers that insiders trade information as much as they would indulge in direct trading. It is also hard to justify the entreprenure being allowed to do this or tip generally on any kind of rational basis.

From the British point of view there might be some support for Professor Manne's arguments given the propensity of certain companies, and in particular Slater Walker Securities, to promote personal share dealing companies for executives to provide incentive. Given the financial collapse of the Slater Walker Group, one wonders if such 'entreprenural activity' should be encouraged on economic grounds let alone moral or social. It is true that when an economy is in a state of depression and there is a significant rate of inflation normal executive remuneration

through salaries is likely to be an insufficient stimulus to incentive activity.[21] But few are likely to have the capital or credit to risk in the equally depressed securities markets, regardless of whether many but a tiny handful would have the ability to generate or obtain sufficiently sensational information.

It has also been argued that the prospect of liability, particularly the crushing liability that seems possible in the United States, is a disincentive to persons who would otherwise be eligible to be directors to accept such an appointment. Certainly it is true that many firms of stockbrokers and merchant banks now actively discourage or indeed prohibit their senior officials accepting directorships. Where managerial skill is scarce this is obviously a matter of some concern. There is undeniably a need for the law to be reasonably clear in such cases and not through the additional burden of uncertainty on the potential insider. Having accepted this last point, there would seem to be no problem for insiders in accepting such appointments, they should merely refrain from trading whilst in possession of material confidential information. In certain instances where a great many directorships are held, the prospect of jeopardy is much greater,[22] but then is it desirable that a man should be allowed to place himself in such a position, that he cannot be reasonably expected to know exactly what he is doing, or what his investment position is in each of the relevant companies.

It has been questioned whether insider trading laws would have the result of discouraging directors from holding shares in their own companies, which many consider desirable in that it promotes identity of interest with the financial fortunes of the company. Given the increasing recognition that the mere provision of labour should entitle participation at least in management one wonders whether this extra economic identification is as necessary as it might have been in the past. In any case given the dimensions of modern corporations it is unlikely that most directors are going to hold but a derisory proportion of the whole. However, as has already been pointed out, the sole prohibition here being considered

is that directors should not trade whilst in possession of inside information, this should not inhibit honest directors from trading when not in this prohibition.

On the other hand it has been said that insider trading can be criticised from the standpoint of management in that it allows managers to manipulate events and in particular corporate disclosures to benefit their own trading positions. Whilst it is certainly true that the Congressional Committees found evidence of directors timing disclosure for the benefit of pool operations it is doubtful how far such could be done today. In many cases corporations are not in control of the disclosure scheme and very few corporate executives would be in a position to dictate the timing of corporate disclosures. Of course this is not to deny that in many instances of possible takeover operations, one of the potential participants has not suddenly and unexpectedly come up with some item of important information that should be brought before the shareholders. Disclosures can certainly be very opportune. Given the speed at which transactions in securities can be executed it is doubtful whether there would be any need for executives to specifically plan to delay disclosures. Where information itself is manipulated then the law already provides remedies.

It has also been argued that insider trading can injure the commercial operation of the company and its reputation. This would surely depend upon the circumstances. Although this problem is dealt with elsewhere it should be noted here, that otherwise than by effecting the possible ability of a company to take full advantage of the capital markets this ground is not over persuasive.

Directors and other officers undeniably owe certain duties of loyalty to their corporate principals and it may be argued that if such are at liberty to indulge in insider trading there may be a diversion from the pursuit of the company's objectives.(23) This surely goes too far, Corporations are not entitled to the full and undivided services and attentions of their officers all the time. Associated with this point is that an ability to engage in insider trading may adversely effect the determination of insiders to avoid the collapse of their company. Considering that security of employment and direct

remuneration is likely to be far more important to the average executive than his investments in the corporation, again this is hardly persuasive.

Turning to the effect that insider trading might have on the securities markets as a whole, it has been argued, again by Professor Manne, that insider trading actually renders the markets more efficient. By an efficient market economists generally mean one where there is a high degree of absorption of pre-release information and thus a gradual adjustment of price rather than a heavily fluctuating market.(24)

It is argued that insiders by basing their trading on inside information iron out misguided flucuations and bring the market price down to that which reflects more accurately the true situation. This appears dubious, given the likely dimensions of insider trading in any sophisticated market. Manne goes much further than arguing that insider trading can and does influence prices, which in certain circumstances few would disagree with. He argues that the market is divided between those who possess inside information or reliable information, and those who trade merely on that general information that is publicly available. Given the certainty aspect of the insiders information they will be the dominating market influence and will bring the market into accord with the real information. There is no real as opposed to theoretical evidence that insiders could or indeed do have this result through their trading on the market. Indeed what evidence there is available suggests that insider trading has a negligible impact on the market. It would also seem that there is little evidence of trading induced or attracted by the insiders transactions.(25) Moreover, it is not necessarily the case that sharp rises or falls in the market price will do more damage to the confidence or performance of the markets than gradual leakages of information. Indeed, as is discussed later, most organised securities markets suspend trading to allow to a sharp readjustment of price consequent upon a corporate disclosure. Certainly fewer persons trade under the influence of the false market.

Perhaps one of the most important considerations is the effect that unrestricted insider trading has or may have

should it attract sufficient publicity, on the confidence of the investor. Obviously the attraction of capital to the market which is the traditional allocator of the scarce capital resources of a market economy is a critical consideration. It would seem obvious that public respect for the integrity of a market will diminish on the knowledge that insider trading and manipulation can and do occur thereupon. Furthermore, public investors would expect to be if not on the same level as an insider with regard to investment in the relevant issuer, at least subject to a substantially equal degree of risk.

It is thus thought that the arguments adduced in favour of allowing insider trading to take place do not over ride the wider principles of fairness already mentioned. Indeed there would appear to be substantial reasons for prescribing the practice. Thus it is both legitimate and desirable to examine the scheme of regulation both in operation and proposed in the United Kingdom and elsewhere.

CHAPTER II

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INSIDER TRADING AND THE QUESTION OF DISCLOSURE IN BRITAIN

(I) INTRODUCTION

The ability of corporate insiders and their associates to trade on the basis of privileged information is obviously inter-related to the effectiveness and extent of the corporate disclosure mechanisms employed in that particular environment. Insider trading is only objectionable where the insider utilises non-public information acquired by virtue of his special position, the actus reus of the 'offence' is the trading in corporate securities without a proper disclosure of the information influencing the transaction. It is axiomatic that in those countries where corporate disclosure is poor or unreliable investors are reluctant to trust their fortunes to equity investment.(1) The point was well made by the Whitepaper on Company Law Reform,(2) the point was also made that 'the more people can see what is actually happening the less likely they are to harbour general suspicions - and the less opportunity there is for concealing improper or even criminal activities. Openness...is the first principle in securing responsible behaviour'.(3)

Thus disclosure of corporate information has the dual effect of allowing an investor to determine what would be the most beneficial allocation of his wealth, for the purpose of producing more wealth, and also the effect of affording investors and also the public a degree of confidence in the way that the means of production are being managed, and the propriety of the utilisation of scarce capital resources.(4) Both are necessary elements in the modern capitalist world. The so called disclosure philosophy has a long history, and was clearly announced by the Select Committee on Joint Stock Companies, as early as 1844.(5)

The disclosure approach in company law was a direct result of the laissez faire attitude of the time.(6) Provided that investors were given an adequate degree of information about a particular enterprise it was up to the individual concerned to make up his own mind, and then protect his investment, either by action within the

enterprise or in the last resort by liquidating his investment. The Government would only intervene to prevent fraud or a blatant disregard of this principle.[7] The primary notion was summed up by the Israeli Committee on the Issuance and Trading of Securities.

The Committee stated, 'to give the Authority broader powers than disclosure...would impose upon the authority... excessive responsibility and would inordinately restrict economic initiative'.[8] Of course it is now recognised in Britain, that in many areas disclosure, whilst of extreme importance is not the universal cure that the Victorians seemed to consider that it was.

Although there have been instances in Britain where disclosure has itself been utilised to curb abuses and fraud,[9] rather than as a mere means of providing information, it is the Americans that have fastened particularly upon this aspect of disclosure. The immortal words of Louis D.Brandeis that 'sunlight is...the best disinfectant, electric light the most efficient policeman, 'hardly need repetition here.[10] Closely related to this aspect is the impact that disclosure can have as a deterrent or as indeed a sanction. Thus for our present purposes it is convenient to isolate three distinct aspects to disclosure and the philosophy that surrounds them.[11] These aspects are,

(a) where disclosure is used as a means of providing information that will enable the reasonable recipient to arrive at an informed decision about his present and future conduct,

(b) where disclosure is used to facilitate the enforcement of specific prohibitionary norms. In this instance the disclosure may be directed at the forbidden act or the violator of of course both.

(c) where disclosure is used to provide a sanction or as a means or preventing or at least discouraging a certain type of conduct, which itself need not necessarily be forbidden. The effect is directed to the relevant pressure group or agency which is capable of exerting some kind of influence on the subject.

Invariably any specific enumeration of aspects of a concept, such as disclosure, will be fallacious, and the present

instance, is no exception. However whilst it is obviously possible to envisage a number of other aspects, the three referred to, neatly emphasise those factors particularly germain to the regulation of insider trading. However it will be evident that the three aspects, disclosure as a means of information - the labelling effect; as a means of enforcement; and as a sanction, whilst distinct enough in theory are practically intimately related in both their application and result. Thus no attempt will be made to discuss them distinctly, other than with regard to the third aspect, disclosure as a sanction, as this has special relevance in the regulation of insider trading.

Before we enter upon a detailed discussion of the British pattern of disclosure, it is necessary to briefly point out certain facets of the subject that should be borne in mind when discussing this area. It is important to appreciate that disclosure cannot be adequately studied in the abstract and that it is essential to examine the direct and indirect impact that certain information will have on the particular subjects. Disclosure in all its aspects will ideally be tailored to a specific category of recipients, its effectiveness will depend upon the dissemination, understanding and access to the information on a consistent basis of this group and its constituent members. This is particularly relevant in the case of the provision of information to investors for the purpose of allowing them to come to a sensible investment decision. Thus as the requirements of the Stock Exchanges listing agreements have been directed towards the goal of providing information to investors and their professional advisers on the market, it is hardly surprising that social and environmental disclosure will be absent. To criticise this is to misread the mechanisms.[12] Particular groups have particular informational needs,[13] and to confuse such, or try and accommodate all in one scheme is to invite disaster.

Another factor worthy of mention is that there have been and are today trends and alterations in the pattern of disclosure. Whilst the British disclosure system is probably one of the most advanced in the world, it is interesting that Peter Shore, M.P. could state with some justification in 1965, that 'far too much of industry has

what I would call a Victorian Attitude to disclosure, company affairs are treated as the Victorians used to treat their bathing costumes - that they ought to be very decent and all-covering'.[14] In recent years there has been considerable pressure for a greater degree of 'public interest disclosure' rather than the traditional company-investor disclosure pattern.[15] It is more than likely that the traditional patterns of disclosure will alter radically in the next few years. Whilst the greater availability of corporate information on a reliable and timely basis obviously to a greater or lesser extent curbs insiders opportunities to misuse their position, much of this information is likely to be of not too greater significance in the determination of investment decisions as such.

(2) THE SCHEME AND MECHANISM OF DISCLOSURE

The British disclosure scheme like that of most economically developed nations is dualistic, in that it composes a level of legal regulation and a more exacting self-regulatory level of disclosure required by the Stock Exchange.(16) Obviously both levels are composed of highly technical rules that it would be impossible and misleading to attempt to adequately describe in detail here, thus attention will be given only to the broad structure of disclosure, and those aspects of particular relevance to the regulation of insider trading. Furthermore it should be appreciated, that disclosure as a means of information, in the context of insider trading is far more important when it is prompt and timely, and that it is information of an essentially sensational kind that affords the best opportunities for abuse. This area of timely disclosure will be discussed elsewhere. Another consideration that permeates the system of disclosure is that the subject of the disclosure requirement is invariably the person obligated to make the disclosure, and thus there is a strong incentive on that person to bend the mechanism so as to best accommodate his own interests. Thus the integrity of disclosures depend upon the degree of integrity of the reporters and the degree of surveillance that is and can be exercised.

Having said this, attention will now be given to the system of disclosure, which will primarily involve the first two aspects of disclosure referred to above, namely disclosure as a means of information and as a means of enforcement. The present analysis will focus upon three broad catagories of disclosures,

(a) Information required to be filed at the Companies Registration Office,

(b) Information retained by, and available at the Company itself,

(c) Information sent to shareholders individually.

(A) INFORMATION REQUIRED TO BE FILED AT THE COMPANIES REGISTRY

(1) THE LEGAL REQUIREMENTS

The Companies Acts require that a wide amount of information be filed at the Companies Registration Office and thereby available to public inspection. In general the information concerned here is that relating to the company's capital structure, constitution, seat and officers.(17)

The company's constitutional documents must be filed with the Registrar under Section 12 of the 1948 Act, as must any alterations.(18) Under section 21 of the 1976 Companies Act a statement must accompany the constitutional documents containing the names and relevant particulars of the directors and secretaries. The relevant particulars are those details which are required to be included in the register of directors. By virtue of section 200 the company must keep at its registered office and send to the Registrar, details of its directors and secretaries. The details are kept in the form of a register, must include the name, address, nationality, occupation, particulars of other directorships held, and in some cases the age of such persons.(19) However, it is not necessary for the register to contain particulars of directorships held by a director in companies of which the company is the wholly owned subsidiary, or which are the wholly owned subsidiaries either of the company or of another company of which the company is a wholly owned subsidiary.(20) Within a period of fourteen days from the appointment or from a change of appointment the company must make a return to the Registrar of the relevant particulars.(21) Furthermore it should be noted that under Section 200(9) 'a person in accordance with whose directions or instructions the directors of a company are accustomed to act shall be deemed to be a director or officer of the Company' for the purposes of this section.(22)

Section 23 of the 1976 Act requires the company to disclose the location of its registered office, in the statement required to be made under section 21. Similarly section 107 required such a notice for companies filing their documents before 1977. Under both sections changes in the location of the registered office must be notified to

the Registrar within 14 days. This information allows the public to find out where the additional and perhaps more up to date information that companies are required to maintain at their registered office, is in fact kept. Where the company keeps the register of members or debentureholders elsewhere than its registered office similar notice must be given to the Registrar.(23)

Information relating to the share capital must also be given to the Registrar,(25) as must the creation of charges on the company's property and acquisitions of property already charged.(26) Yet another important source of information about the company is that provided by the filed prospectus of a public company, or its statement in lieu of prospectus.

Apart from information which must be filed within a reasonably short time of the event, there are requirements directed to providing a consolidated picture of the periodic information over the last year. Every company having a share capital is obliged under Section 114(1), every calendar year to make a return to the Registrar of Companies containing such information as is laid down in Part I of the Sixth Schedule of the 1948 Companies Act, in such form as is provided in Part II. In the case of companies with a share capital the information contained in the returns as to allotments must be consolidated, as indeed must the information relating to the register of members. Paragraph 5, of the Sixth Schedule requires that a list containing the names and addresses of all persons who on the fourteenth day after the company's annual meeting were registered as members, as well as the names and addresses of those who ceased to be members since the last annual return must be filed.(27) This list must also contain information as to the number of shares held by each of the existing members at the date of the return, specifying the shares transferred since the date of the last return by persons who are still members and have ceased to be members, respectively, and the date of registration of the transfers. Furthermore paragraph 6 of the Schedule requires that the information contained in the register of directors and secretaries be included in the annual return.

Before the 1976 Companies Act, under section 127 limited

companies were required to annex to the annual return a copy of the balance sheet for the relevant period, and a copy of the auditors and accountants report.[28] Under the provisions in the Act it was possible that the accounts so annexed might be three years old.[29] Of course now under section 1 of the 1976 Act an obligation is placed upon limited companies to register the accounts and reports within narrowly defined periods, which are still, however generous.[30] The effect of this is that the registering of accounts is now divorced from the filing of the annual return. Of course most companies provide the necessary information in the form of an annual report to shareholders, which substantially complies in its formation with Part II of the Sixth Schedule. Under the 1976 Act the provisions relating to noncomplience have been significantly tightened up.[31] In particular an obligation to lay and deliver the accounts and reports is now placed specifically upon the directors themselves under section 4. Where there is persistent default in complying with these provisions the director concerned might well be subjected to a disqualification order.[32] Another important addition to the enforcement machinery is the power of the Court on application to make default orders.[33] This is a considerable improvement on the previous situation.[34]

It has been increasingly recognised in recent years that the filing of information at the Companies Registry is a deficient disclosure mechanism.[35] Successive Governments and the Department of Trade and its predessors have only been able to secure minimal compliance. The White-paper, entitled Company Law Reform [36] stated that,

> 'there is obviously a massive difficulty in enforcing these provisions over the very large field represented by all limited liability companies. The position is not improved by the fact that the present provisions allow the latest accounts filed with the Registrar to relate in extreme cases to events nearly three years old...furthermore a very sizeable proportion of companies...are at any one time late in filing their annual returns.(37)

Concern was also expressed at the extremely low level of

fines that were actually imposed by Magistrates, when cases were brought before them.[38] Of course the provisions of the 1976 Act will no doubt go someway to dealing with these problems. However, there has been considerable concern expressed in Parliament, in the last few years about inadequate enforcement.[39] The Secretary of State for Trade stated in 1970 that the Companies Registration Office seeks as a matter of practice to 'secure compliance before proceeding to prosecute'.[40] In 1973, Sir Geoffery Howe, the Minister of Trade and Consumer Affairs, stated that the Registrar before considering a prosecution would send three reminders to the company in default.[41] It is true that in recent years the number of prosecutions has greatly increased.[42] However the conviction figure remains relatively low. Computerisation has and will continue to help in enforcement.[43] Now defaults can be automatically identified and some 10000 reminders can be despatched weekly.[44]

(2) THE COMPANIES REGISTRATION OFFICE.

Probably far more serious than inadequacies in enforcement, which are in any case apparently being cured, is the moving of the Companies Registration Office from its traditional location in City Road to Maindy Buildings in Cardiff. Although the move was supported by virtually all the political parties, from outside Parliament the move was greeted with almost universal and trenchant criticism. The highly controversial decision to transfer the records at the Companies Registration Office and its 1000 civil servants to Cardiff was allegedly taken as a result of the recommendations of the 'Hardman Report' on the Dispersal of Government Work from London. Sir Geoffery Howe, The Minister for Trade and Consumer Affairs at a Conference, on Company Law Reform, organised by the Financial Times and Investors Chronicle (45) emphasised that the 'plan is not the result of some wild and irrational impulse on the part of the Government, but on the contrary it is the consequence of a cool managerial decision'. The Secretary of State for Trade and Industry two weeks later, circulated a D.T.I. memorandum enumerating the reasons for this 'cool managerial decision'. The primary reason for the move was stated to be 'the growth in registration work and in searches of company files. 'In fact total workloads had been increasing annually by some 25%.(46) In 1973 there were some 1,944,944 public searches, alone.(47) Of course it also has to be remembered that since 1969, the Companies Registration Office provides a limited amount of information in response to telephone inquiries.(48) Obviously the number of searches and inquiries is not constant and on some days the staff have been faced with over 11,000 searches.(49) The D.T.I. in its memorandum stated that because of the inevitable overcrowding of public search facilities great inconvenience was being caused to inquirers. The Governments answer, rather illogically, was to transfer the records some 153 miles away from London, and reduce the viewing seats in the City from 426 to 400. Furthermore the Government added that the London Registry was simply running out of storage room for the filings that were made. Indeed Sir Geoffery Howe stated, 'our projections show that nothing can make the

Companies Registration Office an efficient operation in Central London. Unless radical action is taken...there will be a virtual breakdown in the whole operation'.(50)

The Government in its memorandum referred to the increasing difficulty of finding suitable staff in the Central London area, and stated that to reduce the delay in registrations the staff had been doubled in the last five years, nonetheless 'pursuit of default in filing accounts is some two years behind schedule'.(51) It is interesting that the vast majority of new recruits in the Companies Registration Office are clerical officers and assistants, and that out of the new 500 employees, there has only been an increase of 14 examiners in the section concerned with the prevention of fraud.(52)

One of the most significant factors in the overwhelming of the Companies Registration Office has been the vast increase in company incorporations and in particular the quantity of shelf-companies.(53) Another significant problem has been the lack of automation, and the almost exclusive reliance on manual procedures. The D.T.I's memorandum emphasised that no matter what short term expedient was adopted, an increase in automation particularly with regard to the retrieval of information was vitally necessary. In particular the Government was concerned that computerisation would substantially assist in the detection and identification of defaults and villations. Whilst as we have seen the advent of computerisation has had a marked effect on the number of prosecutions brought, the figure is less than was expected,(54) and the Department of Trade still insists that criminal prosecutions should be a last resort. Furthermore it is interesting that there were more prosecutions brought in 1973 before the programme of computerisation had been completed, than in 1974 when it had become fully operative.

The Department of Trade and Industry, emphasised throughout the debate that the principle search facility would continue to be located in London, and it would be served by a micro fiche system. The Government stated that there would be a micro-fiche envelope for each Company

on the register, and each envelope would include three sets of materials.(55) One would include the incorporation documents, subsequent changes in capital structure, the location and changes in such, of the registered office, appointments and changes in directors, over a seven year period. The second set would include the annual return, which comprehends the accounts, directors reports, particulars of shareholders, for the last three years and gradually with the effusion of time this would be extended to seven years. Finally the third set would include the mortgage register, and relevant documents to such. The Governments original plans were significantly less extensive than this.(56) Sir Geoffery Howe, stated that the new service would provide the public with at least 80% of all the information that they would require, and the remainder would be available at Cardiff.(57) Whilst this sounds reasonable, it should be noted that it was not until the summer of 1974 that the Registrar started to issue questionnaires designed to determine inquirers informational needs, so it is difficult to see how the Minister of Trade and Industry arrived at the percentage he did.

Considerable opposition was raised to the move of the Registry. The Labour Research Department, and a number of trade unions protested on the ground that they would not have staff available at Cardiff to ascertain vital information for collective bargaining.(58) The City of London Solicitors Company, and Law Society saw the move as endangering the financial preeminance of the City, and thought that the non-availability of vital information would be highly detrimental to the working of London as a capital market.(59) The press in the last few months of 1973 contained almost daily attacks on the move, from an extraordinary variety of interests.(60) The Deputy Chairman of the Stock Exchange, Mr Dundas Hamilton emphasised that Members of the Exchange and the Quotations Department had need of thorough records very frequently, and in great urgency.(61) The magazine Accountancy Age published the results of a survey that it had undertaken among the London firms of Chartered accountants, and some 80% stated that they on a number of occasions had to have immediate access to detailed corporate records. Furthermore they considered

that the information that would be available in London would be mostly insufficient for their needs.[62] A special working party of the Association of Certified Accountants, whilst admitting that computerisation of the records was desirable, thought that there would be considerable expense in having to use the facilities of search agents, or in sending employees temporarily or permanently to Cardiff. Of course certain inquiries cannot be handed over to outside agencies because of the need for secrecy.[63]

The Companies Registration Office sought to answer a number of these objections by drawing attention to the fact that several copies of the documents would be available, and thus searches would be speeded up and facilitated,[64] and a subscriber service would be available where by personal and private libraries could be created.[65] It is certainly possible that the City Institutions, and perhaps the larger financial houses could take advantage of this service, but it is expensive. It is interesting that a number of financial houses and professional firms have established or are intending to establish offices in Cardiff.

Whilst there is no doubt great weight in the Governments desire to modernise the Registry and facilitate enforcement through automation, it is doubtful whether the primary reason it advanced for the move to Cardiff is wholly valid. Whilst it is true that incorporations have increased rapidly in recent years, there are signs that the number is decreasing, and with suggestions for new forms of business organisation and the likelihood that minimum capital requirements will be introduced in the near future the argument is far from convincing. Furthermore much of the backlog was caused by the abolition of exempt private companies, and the increased disclosure requirements of the 1967 Companies Act. Thus it is reasonably clear that the increase in work and paper would not have continued in the dimensions that the Government indicated. Similarly the cost of labour and office space has not risen in the same way in recent years as it was feared it would.

What is perhaps the most disturbing question in the Governments approach, is the utter disregard of the twenty

or so per cent of users who will not be accommodated by the new scheme. In a Circular issued by the Companies Registration Office in November 1973, it is simply stated that 'the small number of people who need to browse in an old file will need to go to Cardiff'. Whilst it would no doubt be too expensive to micro film all the information that is currently available in the Registry, the dangers in restricting its access by transferring it to Wales should not be underestimated. Whilst officials at the Department of Trade have dismissed these users as 'mere browsers who do not often know what they are looking for'(66) this neglects the fact that among such are officers of the various police fraud squads, and a host of other official and quasi-official user. Peter Wilsher(67) considers that the Department of Trades approach 'is remarkable' and fallacious. Scotland Yard, had seconded four full time specially trained researchers, and a police telex operator to the Companies Registry in London, who on average made some forty investigations each day, and annually carried out some 10,000. Obviously these inquiries are often complex, wider ranging and urgent, and more to the point it is invariably necessary to go further than the information which is now contained in the micro-fiche envelopes. The accuracy, reliability and confidentiality of the investigation is of extreme importance, and the police would thus be reluctant to use outsiders. In addition individual officers will be engaged in their own investigations, and many will require facilities to make personal searches themselves, particularly if they are essentially on a 'fishing expedition'. It goes without saying that a Detective is not going to have or often be given the time to just 'pop down' to Cardiff to browse in the records, as he could once have done with ease in the City Road.(68) The problems caused by the move of the Companies Registry were discussed by the police at a two day conference on the investigation of Commercial Fraud, in November 1973. A Chief Superintendent of the Metropolitan and City of London Companies Fraud Department, stated that 'our big worry is one of divorcing the routine search operation from the accumulated knowledge and experience that we have built up in London. We are not usually interested in bare, face-value information carried in the files. But we have

officers with long memories and deep experience who can put together names, addresses, and odd bits of information - often from half a dozen apparently unconnected sources and companies and come up with all sorts of leads. 'Now we get inquiries from all over the country, and we can pool our knowledge suggest places and ways to look, and if necessary go around to Companies House ourselves. That will no longer be possible in Cardiff'.[69] In a Times Editorial the same point was made,[70] and the Sunday Times doubted whether 'the new category of 'white collar criminal' such as the insider could be adequately caught with the full records only being available in Cardiff.[71] It is open to doubt whether the Scotland Yard researchers will remain with the Registry, and it is dubious as to whether the Cardiff police would be willing to take over this role.

Of course it is not only the police that are concerned with this type of 'browsing'. There have been numerous instances where individuals who are either dealing with a corporation, or who are indeed members of such have taken the trouble to detect irregularities and frauds by making personal inquiries. Now if an in depth analysis is required the would be searcher would have to journey down to Cardiff, and perhaps incur expenses for accommodation, where the search cannot be completed in a single day. Furthermore browsing through documents is far easier than scanning micro-fiche. Another extremely important browser is the financial journalist. Peter Wilsher the Editor of the Sunday Times Business News, has remarked that often journalists to check out their suspicions have 'to follow the threads back to the year dot, jumping from half clue to half clue over a mound of forgotten files'.[72] Solicitors, accountants, credit protection agencies and a variety of other persons cannot always satisfy their needs by the kind of information that would be available on micro fiche, even if the Companies Registration Office with the aid of its computers can ensure that filings are kept reasonably up to date. It is at least arguable that the needs of these unaccommodated 20% of users are likely to be more important from the public interest point of view than the eighty per cent of ordinary users. It is because of their special

needs that they are important, and it is misconceived to merely retort that the information is available still in Cardiff.

Search facilities will, naturally be available in Cardiff, and a 100 micro-fiche viewing stations have been installed, in addition to the 400 in London. The Registrar of Companies stated at a meeting of the Law Stationers Association, that no original files will be available even at Cardiff except on completion of a special questionnaire, and certainly not all documents will be on micro fiche even at Cardiff.(72)

Another problem is that the micro-film equipment installed, as normal viewing equipment cannot produce full size copies and particularly in the case of lists of shareholders it is probable that special viewing stations will have to be used.(73) Thus a searcher could have to search through, original documents, and two categories of micro fiche in two different viewing stations.(74) There have been other technical problems.(75)

The City was particularly concerned about the impracticalities of having to file documents, particularly prospectuses in Cardiff, and when a new Government came into office considerable pressure was applied on the relevant Ministers to reconsider this aspect of the new scheme.(76)

A deputation from the City institutions, had a number of meetings with Department of Trade officials and the Secretary of State for Trade, Mr Peter Shore.(79) The main result of these persistent representations was that the Government agreed to make a concession with regard to the filing of documents. Under the revised plan prospectuses, mortgages, Court orders and appointments of receivers can be filed at Cardiff or London. The Government also agreed that whilst at first the bulk of the material available in London on micro fiche would date back only three years details of, and changes in directors and officers would as from the start date back the full seven years. However where shareholders lists are not included as part of the annual return, but filed separately, they are not available on micro fiche in London and reference has to be made to Cardiff. The Registrar on a number of occasions emphasised that both offices would be in telex communication and that the facilities for facsimile communication between London

and Cardiff would be streamlined and that a postal service would be initiated, whereby inquiries could be answered by post. It is submitted that the new scheme will provide a better and more efficient service, except with regard to a small, but as we have seen, important category of user. Even if it is possible for the police to provide resident searchers in Cardiff, and presumably the Department of Trades, Companies Investigation Branch would have its own officers there, the problem of the private, press and semi-official user, such as the Takeover Panel or Stock Exchange is not solved. Whilst it is likely that only a small proportion of these investigations would necessitate searching beyond the information stored in London, especially as the programme advances and the information relates back some seven years, it is certain that cases will arise where the London information is insufficient. Furthermore the opportunity for 'indepth' browsing is removed.

It would appear that there is now only one practical solution, given the fact that the move has taken place and some £7,000,000 has already been spent. This would be to extend the micro-fiche service to all documents presently in original form at Cardiff. This would be very expensive, but surely the protection of the public against fraud and abuse is a consideration of greater weight. Of course, any change is likely to generate a certain amount of criticism(79) but in the present case much of it is well founded.

The deficiencies in enforcement of the filing and disclosure requirements have already been alluded to. The Conservative Government in its White Paper on Company Law Reform,(80) promised to create a specific obligation on directors to file the required documents, and prescribe with some strictness the period after the termination of the company's financial year in which this must be done. In addition the then Government promised to correct the 'practical inadequacy of the present enforcement provisions.' The Companies Bill 1973 would have given effect to this promise. Clause 58 would have required directors to prepare and lay before the General Meeting, as well as deliver to the Registrar the accounts and

required annexed documents,[81] and by virtue of Clause 59 this would have to be done within seven months from the end of the financial year to which such related, or ten months in the case of a private company. The Companies Bill would also have strengthened the penalties for non-compliance with the filing requirements.[82] Although the Secretary of State for Trade and Industry during the Second Reading of the Bill stated that the increased penalties would show that default was 'a serious offence and not a mere technicality'[83] Nigel Spinks has commented that 'as for punishment for late filing...the experience of the Registrar has shown that penalties act as a deterent to filing and not as an inducement'.[84] The subsequent Labour Government agreed with the sentiments expressed in the legislative proposals contained in the 1973 Bill,[85] and such have been substantially enacted in sections 1 to 7 of the 1976 Companies Act. Section 5 is of particular interest in that it allows a shareholder, creditor of the Registrar to apply to the Court for a compliance order.

(B) INFORMATION MAINTAINED WITH THE COMPANY

A number of provisions in the Companies Acts require the company to maintain specified records and registers generally at its registered office. A lot of this information duplicates that required to be filed at the Companies Registration Office. However, as the information maintained with the company has invariably to be kept substantially up to date, the continuous disclosure programme provided through this mechanism is far more immediate than the other two mechanisms of disclosure. Obviously a high proportion of the information that companies are required to keep although no doubt adding to the overall disclosure scheme, is of little interest from the point of view of insider trading. Thus attention will be given in detail only to those aspects directly relevant to the topic under discussion.

The practical utility of the present disclosure mechanism obviously depends on the availability of the information maintained by the company to investors and others. Under Section 426 it is provided that any person may inspect documents maintained by the Registrar of Companies and obtain copies thereof on payment of a fee.(86) If the information required to be kept by the company merely duplicates that in the Registry generally it is open to public inspection. It should be remembered that even if the information is available at the Registry the information maintained by the company will be more up to date. This is particularly the case with the register of members maintained by the company and the particulars of shareholders supplied annually to the Registrar.

The register of members, under Section 113 and the register of directors and secretaries under Section 200 are open for public inspection on payment of the statutory fee, and open to members without charge. The register of charges is open freely to members and creditors, but only to others on payment of the statutory fee, under Section 104. However under Section 105 whilst available to members and creditors the instrument creating the charge is not publicly available. Whilst the Companies Acts do not in fact require a register of debentureholders(87) sections 86

and 87 do contain provisions for the maintenance and inspection of such, along the same lines as with the register of members.

With regard to the mandatory minute books, section 145 requires that minutes be recorded with regard to proceedings of the general meeting and of the directors. However section 146 is silent on the question of who is entitled to inspect the minutes of directors meetings. Thus it would appear neither the public or shareholders have the right to examine such, although at common law it would seem directors and their advisers do.[88] With regard to the minutes of general meetings the members of the company have a statutory right of inspection under section 146.

Where registers or books are available for inspection under the Companies Act, the standard provision is that the registers are to be kept available during business hours, subject to such reasonable restrictions as the company may by its articles of association or in general meeting impose, so that not less than two hours in each da are allowed for inspection, at its registered office. Where there is non- compliance the company and every offic in default is liable to a default fine, and the Court can be approached for an order compelling inspection.[89]

In the case of books of account or accounting records section 147(3) provides that such 'shall at all times be open to inspection by the directors'[90A] although apparently not the shareholders or anyone else, except of course the auditors. However in the case of companies wi articles of association in accordance with Table A, artic 125 it is provided that 'the directors shall from time to time determine whether and to what extent and at what tim and places and under what conditions...the accounts and books of the company or any of them shall be open to inspection by the members.' It would seem under this article the general meeting could empower someone to inspect the books, and this has been for instance in the case of Courtline.[90] Nevertheless the British shareholder or debentureholder as an individual has no right of inspection of the books of the company.[91]

The position is different in the United States. The American courts employing on the concept of a shareholder as a co-venturer have always allowed generous rights of inspection, on a stewardship basis. The right of inspection of the corporate books and records has become fundamental to the viability of derivative suits and proxy contests aimed at management. Inspection of shareholders lists, although often spoken of as a common law right, in most states has received statutory recognition. This particular right is narrower in scope and more freely granted than the right to examine the corporate records.[92] The wider right to inspection of records has also been embodied in statute in many states, although where more expansive the common law still applies.[93] However under the common law the shareholder has the burden of alleging and proving a proper purpose.[94] The common law, and statutory rule in most instances allows a shareholder to inspect corporate records, when 'acting in good faith for the purpose of advancing the interests of the corporation and protecting their rights as owners'.[95] This right includes the privilege of allowing the shareholder to be accompanied by a professional adviser to assist in the interpretation of the records.[96] There is some controversy as to whether directors have an absolute right of inspection, or one conditioned upon proper purpose.[97] The inspection has been extended to internal corporate information, not constituting records as such.[98] As a normal rule confidential communications, trade secrets and 'inside information' would not be available.[99]

Thus the rights of individual shareholders in American corporations to inspect the documents and records of the company are far in excess of anything that the British shareholder possesses. Of course, in Britain, a shareholder can always avail himself of the ordinary methods of obtaining evidence and discovery of documents in the case of litigation,[100] and this extends to a member asking the Court for an order enabling him with professional assistance to inspect a company's records or documents if he can establish to the satisfaction of the Court that he has a valid complaint to which the evidence sought

reasonably relates. Mere 'fishing' is not allowed, and the Courts order must be directed towards a specific complaint.[101]

It might be convenient to mention here, another possible means for investors to obtain information directly from the company, and indeed exercise a degree of surveillence over the directorate. This is the medium of the general meeting, which in traditional corporate theory if nowhere else is considered the font of corporate democracy. Shareholders are entitled to ask as many questions as they like at company meetings, although there is no obligation upon the directors or the Chairman to answer, and little if anything can be done in the face of an assertion that answering a particular question would harm the interests of the company. Of course, as we shall see elsewhere, investors have been extremely apathetic and reluctant to assert themselves, or even attend shareholders meetings.[102] There are signs that this situation is changing, and at least some shareholders are prepared to question, and persistently demand information from directors.[103] The role of institutional investors in this aspect of disclosure is likewise becoming more significant.[104] However, it would seem that even if a request for information is made at a general meeting and it has a bearing on a proposed resolution it is unlikely that the courts would entertain an interference with the integrity of the resolution, in the absence of fraud, even if it could be shown that the information if it had been given would have been likely to have had a material impact on the voting.[105] The only disclosure obligation on the directors is to give such information in the notice calling the meeting [106] that would enable members to come to an informed decision about the merits of a proposed resolution. It has been authoritively stated a '...special resolution obtained by means of a notice which did not substantially put the shareholders in a position to know what they were voting about cannot be supported'.[107] Directors who seek to derive some benefit from the resolution must declare the nature and extent of such, clearly.[108] Whilst the British law no doubt

gives some protection to investors it is hardly sufficient in this respect.[109]

(i) THE REGISTER OF MEMBERS

Under the terms of Sections 110 to 123 every company registered under the Companies Act 1948 must maintain a register of its members. This register must include inter alia [110] the names and addresses of each shareholder and 'a statement of the shares held by each member, distinguishing each share by number, so long as the share has a number, and of the amount to be considered as paid on the shares of each member'.[111] With regard to the numbering of shares, section 74 provides that each share in a company, having a share capital, must 'be distinguished by its number 8. However, 'if at any time all the issued shares therein of a particular class are fully paid up and rank pari passu for all purposes none of the shares need thereafter have a distinguishing mark so long as it remains fully paid up and ranks pari passu for all purposes with all shares of the same class'. Thus as the majority of shares are issued as fully paid up, and rank pari passu, numbered shares are rare, at least in public companies.[112] However as a matter of convenience registrars utilise transfer and allotment numbers, which will appear in the register of transfers.[113] Certificates are also, again as a matter of practice numbered.[114] The register of members must also show the date upon which the person named became a member and the date upon which such ceased to be one.[115] A practice, which does little harm now, but which could be very significant if anti-insider trading laws were enacted, is that it is not uncommon for registrars to enter in the register not the date when the person named as a member became a member but when he agreed to become such.[116] Of course this is contrary to the Companies Act as a person other than a subscriber to the memorandum, under Section 26, does not become a member of the company until his name is properly entered in the register. If the date that the person became a member is false the register with regard to that member is falsified.

The register of members will invariably be kept at the companies registered office, although it is provided in Section 110(2) that it may be kept at the office where the register is made up if this is elsewhere than the

registered office. It must obviously be situate somewhere in England. If the register is kept at a place other than at the registered office the company must give notice to the Registrar of Companies, as to where the register is in fact to be kept.(117) Of course it is important to note that the register of members itself is not available at the Companies Registration Office, although as we have seen similar details are included in the annual returns.(118)

Under section 113 the register of members and the index(119) must except where the register is closed, under the provisions of the Act, be open for a period of at least two hours a day, as we have already seen. A company may close its register for not more than thirty days each year, provided notice is given in local press of where its registered office is situated, under section 115.(120) Most companies today with the assistance of automation, do not in fact close their registers any more than is absolutely necessary - to do so is regarded as bad investor relations.(121) It is provided in Section 113(2) that anyone can require a copy of the register, or any part thereof, on payment of 10p for every 100 words.(122) The company must supply the copy within ten days, and if there is a failure to do so, or to allow inspection, the company and every officer who is in default(123) is liable to a fine of £2 and a default fine of £2, under Section 113(3), and application can be made to the Court for an order.(124) If default is made in complying with section 110 itself, either by failing to keep a register in the required form, or in failing to give notice to the Registrar within 14 days of moving the register to a location other than the registered office, the company and every officer in default is liable to an unspecified default fine.(125)

An important question from the stand point of tracing past transactions in securities, is for how long is it necessary for companies to retain closed registers and documents such as transfer forms. With the cost of storage and labour many registrars are anxious to dispose of such, as soon as possible. Taken literally Section 110(1)(c) has the effect of requiring companies to retain the records of the shareholdings, names, and addresses,

of persons who have long ceased to have been members. The law gives no guidance on this matter, and considerable controversy has been generated by the uncertainty. Although there is little doubt that a number of companies have taken 'a calculated change' and disposed many old documents, others feel that to dispose of documents of title is a danger they should not encounter. The Chartered Institute of Secretaries, and the Registrars Group, with the assistance of legal advice have commendably attempted to lay down retention guide lines. For instance it is recommended that transfers, debenture, loan stock, redeemable preference and share amortisation records, as well as dividend, debenture and loan stock interest lists should be retained for at least twelve years after they expire. On the other hand dividend and debenture and loan stock interest warrants need only be retained six years, mandates four years, and ordinary correspondence only one year.(126) In the case of registers required to be kept under the Companies Act it would seem to be the opinion of registrars that it would be far too dangerous in the absence of statutory provisions to dispose of old records. The question of retention of documents was considered by the Jenkins Committee.(127) The Committee decided that there was no need for any special exemption in the case of documents relating to dividends as such matters would be covered by the ordinary six years statute of limitations. However with regard to documents effecting title to securities the Committee suggested that there should be a statutory provision providing against the impuning of any entry on the share register relating to a transaction occurring more than thirty years previously. Thus provided there had been no challenge in this period the register could be destroyed.(128)

Whilst the vast majority of shares in the United Kingdom are held in nominative or registered form, under Section 83(1) a company limited by shares, being a public company, provided so authorised by its articles of association, may issue bearer share warrants with regard to fully paid shares. Obviously the presence of bearer shares would make insider trading regulation fundamentally more difficult than the use of registered shares. The Exchange

Control Act of 1947, as amended, imposes stringent restrictions on such securities[129] which have combined with the general dislike of bearer securities in the United Kingdom[130] to render them rare and of very little significance. In many European countries bearer securities have acquired a considerable popularity, at least initially because of the possibilities for tax evasion. This, in the main, has wisely not been tolerated in the United Kingdom. Given the problems of tracing ownership and effecting corporate disclosure where bearer securities are concerned, it is probable that the existence of such have encouraged or at least facilitated insider trading. Fortunately so far as Britain, and most Commonwealth countries are concerned, given their practical insignificance it is possible to pass on without further discussion of the matter.

Before leaving the register of members, it should be pointed out that there are provisions in the Companies Acts for companies which carry on business in part, in some place outside the United Kingdom, yet within the Commonwealth, Colonies, Republic of South Africa, or Federation of Malaysia to keep a 'Dominion Register' of members, composing a register of members resident in that country.[131] As the dominion register is part of the principal register and the details in the branch register appear in the principal one, at the companies registered office, and the same provisions that apply to the principal register apply mutatis mutandis, it is not really necessary to pursue this matter.[132]

Finally, there are several points that should be made, concerning presentation of the register, that could be important, from the point of view of tracing transactions. A listed company is bound by the Stock Exchanges Listing Requirements to 'arrange for designated accounts if requested by holders of securities'.[133] Thus holders of securities may be allowed to have several accounts in their own names, differentiated only by a designation number or letter. The number of separate accounts that may be allowed to be held by a single member in a company depends upon the flexibility of the company's system of numbering of accounts and thus the discretion of the registrar. Transfers of securities from one designated account to another, owned

beneficially by the same person can be made by a written request of the shareholder. The designation of accounts is used to great advantage by large trust and nominee companies, and can of course obscure exactly what transactions have occurred, although obviously this is not the purpose of the facility. Another factor that can cause difficulty in tracing ownership on the register is that securities can cause difficulty in tracing ownership on the register is that securities can be held in joint names or in more than a single name. Under the Companies Acts there is no limit upon how many joint holders can appear in the register as legal owners.(134) Thus in the absence of a provision in the articles of association usually limiting the number to four, all declared joint holders must appear in the register, with the required particulars of Section 110. Most registrars would admit that the information contained in the register can be deceptive and misleading. For instance members do not necessarily inform the company where they change their names or woman changes her surname upon marriage.(135) In large registers amazing coincidences are experienced, for instance in one case two registered members were both Lieutenant Colonels, both had the same initials and surname, and both used the account services of Lloyds Bank Pall Mall.(136) All these factors must be considered, when thinking of the register as a mirror of current ownership.

(ii) REGISTER OF DIRECTORS AND SECRETARIES

When discussing the information required to be filed at the Companies Registration Office, it was stated that Section 200(1) requires that every company must maintain at its registered office a register of its directors and secretary. For the purposes of this provision under Section 200(9) a person in accordance with whose instructions the directors are accustomed to act will be regarded as a director. Of course this is a difficult matter to establish, as directors are unlikely to admit to accepting instructions from an 'outsider' as such itself amounts to a breach of their fiduciary duties. But where such are trying to lessen the burden of blame upon themselves, such proof may arise, as it might from the very circumstances, of the case.(137) Furthermore it should be noted that Section 455 provides that the term director includes 'any person occupying the position of director by whatever name called'.

This register must contain the full names and titles, former names, usual residential address, nationality, his business, if any, particulars of other directorships, his age, of the directors, individually. Where a corporation is a director the company's name and registered office must be stated. It is not necessary under Section 200(2) for the register to contain particulars of directorships held by directors in companies of which the company is the wholly owned subsidiary, or which are the wholly owned subsidiaries either of the company or of another company of which the company is a wholly owned subsidiary. The disclosure requirements with regard to the secretary are less extensive. Only his names, former names, and usual residential address are necessary, although where there are joint secretaries the information must be provided as to each. Where all are partners in a firm, the name and principal office can be stated rather than individual personal details of the partners, under Section 200(3).

As we have already seen the company is obligated to send copies of the register to the Registrar of companies and details of any changes therein.(138) The Register is open to inspection, and copying on the same terms as the register

of members, and there are similar provisions in the case of default.

Under section 407 overseas companies,[139] which have established a place of business in the United Kingdom, but which were incorporated abroad, must supply the Registrar of Companies within one month of the establishment of that place of business, with details of its directors and secretaries, as are required by Section 200. Changes must be notified within twenty one days, and penalties are provided in the case of default.[140]

(iii) THE REGISTER OF SUBSTANTIAL SHAREHOLDERS AND THE PROBLEMS OF NOMINEE REGISTRATION

(a) NATURE OF THE PROBLEM

Various societies for a multitude of reasons, have perfected practices which enable property of all kinds to be held and to all the world appear as owned by a person, who in fact holds it for the benefit of a hidden owner.(141) This very factor of secrecy of the true owner, has an obvious impact on the question of effective and anti-insider trading regulation. It is a fundamental aspect to the detection and regulation of the abuse. The accommodation of secrecy that nominee holding allows is also of significance from the point of view of corporate control, and it is this aspect which has received the most legislative attention throughout the world. There is a greater public interest in it being known who controls and owns the nations capital and means of production than in catching the odd insider trading behind a nominee or associate. Thus it is appropriate to discuss the major topic of nominee registration at this particular juncture.

The register of members required to be kept under Section 110, does not enable the company or indeed anyone else, to ascertain more than the name and address of the registered shareholder. Whilst the Cohen Committee considered that one of the main reasons for the register of members was to allow investors and creditors to see who their coadventurers were,(142) it would seem that when Parliament legislated for this register in 1862 it was only concerned that legal ownership should be reflected. This was quite reasonable as the company, and for that matter most other persons would only be concerned to see who was legally responsible for the rights and obligations of membership.(143) That the original conception of the register of members was only to list those legally responsible participators, from the company's standpoint, is affirmed by Section 117, and its predecessors.(144) This section provides that 'no notice of any trust, express or implied or constructive shall be entered on the register or be receivable by the registrar...'(145) This section

was interpreted by Lord Coleridge, in Re Perkins, ex parte Mexican Santa Barbara Mining Company.[146] The learned Chief Justice stated,

> It seems to me extremely important not to throw any doubt on the principle that companies have nothing whatever to do with the relation between trustees and their cestuis que trusts in respect of the shares of the company. If a trustee is on the company's register as the holder of the shares, the relations that he may have with some other person in respect of the shares are matters with which the company have nothing whatever to do with, they can look only to the man whose name is on the register'. (147)

Although this is not the universal proposition that it might appear,[148] for our present purposes it suffices to state that a company will not accept and will not wish to receive indications of rights and interests laying behind a registered title, in the normal course of events. Indeed registrars as a matter of practice immediately return such notices to the sender explaining the company's lack of interest.[149] It is of course true that whilst the law treats nominees as not being such, 'this noble disregard for reality is not shared by business which rightly considers nominees as being a different catagory from a shareholder beneficially interested in his securities'.[150]

The Cohen Committee observed that,

> 'whatever may have been the intention of Parliament, it is clear that at an early date investors made use of nominees, for as long ago as 1895, Sir Francis Palmer in his standard work, referring to the benefits of anonymity in private companies said, 'This is in many cases a matter of great importance, and especially in the case of syndicates, for it very commonly happens that leading financiers, Members of Parliament and commercial men whilst willing to subscribe to the syndicate, make it a condition that their names do not appear. (151)

It is very difficult to judge accurately just what proportion of securities in Britain are held in nominee form, as the very nature of such resists detection and computation.[152] An indication of the extent of nominee ownership is given by two surveys, one submitted to the Cohen Committee and the other to the Jenkins Committee. Whilst it is appreciated both are now somewhat dated, they do nevertheless provide some guidance. (153)

The Committee of London Clearing Banks in their evidence to the Cohen Committee submitted details on the extent of nominees in the context of the Clearing Banks. It appeared that some 600,000 individual holdings of debentures and shares were registered in the name of member banks of the British Bankers Association or their nominee companies in 1943. Although dated, the analysis by one of the banks of its 72,456 nominee holdings is of great interest, and bears reproduction here. It is important to remember that the following analysis only extends to first tier nominees, and of course there could in many instances by multiple nominees through which the beneficial nexus ran.

The analysis was as follows,(154)

Residents outside the U.K	% of Total	18.38%
Stock Exchange Members	% of Total	8.59%
Insurance and Trust Companies........	% of Total	3.86%
Security for advances................	% of Total	11.16%
For convenience		
(a) Facilitation of Stock Exchange.. transactions	% of Total	8.13%
(b) absence abroad	% of Total	
Executors and Trustees...............	% of Total	49.28%
Unidentified purposes................	% of Total	0.6 %

The Cohen Committee pointed out that it was quite possible that other sections than the one designated as 'unidentified purposes' could well involve the use of nominees for improper purposes and for concealment of identity, rather than because of the various administrative advantages in having securities held in nominee registration. The Committee of London Clearing Banks in their evidence to the Jenkins Committee,(155) presented up-dated evidence as to the extent of nominee holdings in their member banks, and the uses that the device was apparently been put to. The Banks stated that they had some 800,000 individual holdings in nominee registration. The modified analysis, was as follows.

As security for advances	% of Total 4.68%
Stock Exchange Members	% of Total 4.39%
Insurance and Trust Companies	% of Total 1.56%
Pensions and analagous funds	% of Total 5.04%
For Trustees	% of Total 1.26%
For residents outside the U.K.	% of Total 2.41%
For convenience,	
(a) Facilitation of Stock Exchange Transactions	% of Total 4.77%
(b) absence abroad	% of Total 2.08%
(c) general	% of Total 6.26%
For Investment Management	% of Total 16.81%
Executors and Trustees	% of Total 49.83%
Unidentified purposes	% of Total 0. 91%

Again it is to be emphasised that concealment and improper purpose is not necessarily to be limited within the category of 'unidentified purpose'. It would seem that most nominee accounts are somewhat more active than ordinary accounts. Returning to the evidence submitted to the Cohen Committee, the same bank that analysed its users also analysed the work which three of its nominee companies did in 1938, a relatively inactive period on the Stock Exchange. Out of a total 37,974 individual nominee holdings held by the three companies, in one year it was discovered that there had been some 137,215 executed transfers.(156) Moreover in the same year dividends received by the three nominee companies from eight British companies in respect of 1013 nominee accounts, in 840 cases were for overseas beneficiaries. These statistics have obvious implications for the effective regulation of insider trading. In a one day transaction study by the Stock Exchange on August 7th 1974, it was found that a quarter of the value of equity turnover was in foreign company stocks and one half of the deals in foreign company's securities were for overseas clients or on an arbitrage account.(157) Apart from emphasising the importance of London as an International financial centre these figures indicate the quantity of foreign trading that in fact exists. Given this and the extent of nominee trading it is no small wonder that a number of investigations into alleged insider activity have foundered.

The Clearing Banks in their evidence to the Jenkins Committee pointed out that it was likely that an increasing proportion of securities would be transferred into nominee registration in the future.(158) The Banks also emphasised that there had been a marked increase in the number of bank nominee holdings, and in particular there was a growing trend for British banks to act as depositaries and agents for overseas principals. 'In such cases one registered holding in the name of a nominee company may amount to many thousands or even millions of shares the beneficial ownership of which is widely spread and completely unknown, to the British bank'.(159) The memorandum of evidence submitted to the Jenkins Committee by Guest Keen and Nettleford Ltd, made the same point (160) and stated that three out of the ten largest holdings in the company, as of January 1960, were 'known' to be registered in the names of such nominee companies. Given this and the advent of unit trusts and investment clubs, the memorandum stated that 'it was much more difficult to keep a register of beneficial shareownership'.(161) The Board of Trade in the Notes that it supplied to the Jenkins Committee stated that an analysis of shareownership was 'at present impossible because of the prevalence of nominee holdings...'(162)

The second of the surveys referred to above, and submitted to the Jenkins Committee, was that carried out by Messrs J.R.S.Revell and C.H.Feinstein, of the Department of Applied Economics, of Cambridge University. One of the most interesting analyses in this survey was that of the shareholdings of the listed ordinary share capital of United Kingdom public companies. This analysis shows the composition at market value of the shareholdings, based on a sample of share registers of public companies with a stock exchange quotation. The period during which the survey was conducted was from 1956 to 1958. Whilst this is now quite dated, the researchers themselves point out that 'the composition of shareholdings does not change rapidly...and apart from the effects of such general trends as the

increasing use of nominees and the growth of pension funds, it is unlikely that the results for a more recent date would be appreciably different'.[163]

The analysis, submitted by Revell and Feinstein, was as follows,

Insurance and assurance companies.....	% of Total	8.0%
British Banks and Nominees...........	% of Total	15.3%
Pension Funds........................	% of Total	1.2%
Investment Trusts....................	% of Total	3.0%
Other Financial Institutions..........	% of Total	1.5%
Industrial and Commercial Companies...	% of Total	2.0%
Charities and Religious Orders........	% of Total	1.3%
Overseas,		
(a) Holders resident outside the U.K.	% of Total	4.3%
(b) Overseas Banks and Nominees......	% of Total	0.6%
Executors and Trustees................	% of Total	2.1%
Personal Holdings.....................	% of Total	55.6%
Unclassified..........................	% of Total	5.1%

The evidence submitted by the London Clearing Banks should be viewed in the light of this far more comprehensive analysis. The London Clearing Banks stated that nearly 1% of their nominee business 'was for unidentifiable purposes which could embrace concealment'.[164] From Revell and Feinstein's analysis it is apparent that some 15% of the public quoted companies securities are held by bank nominees, thus the degree of unidentifiable purpose, merely in the case of bank nominees assumes a sizeable proportion, or at least one not to be ignored. Of course it is necessary to view any survey with a degree of circumspection and it should be pointed out that John Moyle in '<u>the Pattern of Ordinary Share Ownership 1957 to 1970</u>',[165] analysed the catagories of shareholder in some instances significantly different. For instance individual holdings of common stock, which included that held by executors and trustees, was placed at 47.4% as of the 31st December 1969. The proportions of securities held by the institutions also varied.[166] There would seem however to be little doubt that the proportion of nominee holdings has increased,[167] and Revell and Moyle, in the 'Owners of Quoted Ordinary

Shares - a survey for 1963'.[168] stated that the proportion of nominees had risen from 12.6% on 1st July 1957 to 20.5% as of 31st December 1963.

In their original memorandum of evidence to the Jenkins Committee Revell and Feinstein, pointed out that their task in analysing shareholder composition had been made significantly more difficult by the presence of nominees and that the survey 'took no account of those holdings registered in the names of individuals without any indication that they were trustees or nominees'.[169] Thus they emphasised that although when executors, trustees and nominees were added together the figure was over 17% this was a minimum, and in all probability the figure should be significantly higher. Many registrars whom the present author has consulted, in the case of quoted public companies would today place the nominee percentage at between 22% and 26%, but all agree that it is increasing.[170]

It is hardly surprising that Professor Kahn-Freund writes, 'the thorniest of all the thorny problems confronting the Cohen Committee was that of nominee shareholdings'.[171] The Cohen Committee gave considerable attention to the nominee problem,[172] Among the alleged benefits of disclosure of beneficial ownership, the Committee thought that such would inhibit those unscrupulous directors who utilised such as a cloak for insider trading.[173] Whilst the Committee was not wholly pursuaded of the weight of all the disadvantages it was alleged the nominee system caused, the Committee wisely stated that 'we do not attach conclusive importance to the absence of any proven cases of abuse since in the nature of things such evidence would not be forthcoming'.[174] In the result the Committee thought that full disclosure on the basis 'that the public is entitled to know in whom control is vested' would not prejudice any valid interest. However the Committee did have reservations as to whether beneficial disclosure 'could be effectively and conveniently enforced without causing unnecessary work.[175] The Report repeatedly emphasises the desire of the Committee not to erect an unworkable mechanism the benefits of which could be disproportionate to the work involved in servicing and

policing such. The Committee took evidence and considered a number of schemes to effect complete disclosure. However the Committee considered that 'the majority of suggestions would involve a volume of work out of all proportion to the probable benefits to the public' and that there was no 'watertight' solution that would catch all nominees, particularly the foreign private and corporate nominee.[176] The proposed disclosure scheme was only maintainable if there was 'a reasonable degree of effectiveness' in the Committee's mind.[177]

Abandoning the ideal of complete disclosure, the Committee concentrated on improving the amount of disclosure in the register of members, and in facilitating the disclosure of control, or at least allowing indications of such. The Committee considered that a nominee shareholder should be distinguished on the share register from a beneficial owner.[178] The detection of nominees was to be via a system of declarations, upon every transfer, the form would contain a declaration that the transferee was or was not to be regarded as the true beneficial owner of the securities concerned.[179] With regard to existing holdings the Committee recommended that every company after the proposed law comes into effect should send a form to the shareholders with the notice of the following annual general meeting requiring a declaration of status. It was also suggested that once a declaration had been made if the beneficial owner became a nominee or vice versa, then a declaration should be required to be made to the company. Annual reminders of the duty to declare shareholder status, in the Committees view could be contained in the notices of the annual general meeting.[180] The company in the register of members would keep two lists, one of declared beneficial owners and another for declared nominees.

The Committee refrained from suggesting that declared nominees should be required to state who the beneficial owner was, as the amount of administration that this would require would be disproportionate, and in a case where beneficial disclosure was material the true owner 'could very easily take steps to remain behind the curtain'[181]

and render the scheme a snare and delusion. However the Cohen Committee did consider that an obligation should be placed upon any person who directly or indirectly the beneficial owner of more than one per cent of the capital of the company, or any class of shares, to file a declaration of his ownership within two months of the commencement of the proposed law, or ten days after he became such. A similar duty of notification would exist with regard to any change in such particulars as had been declared.(182) The duty to declare would however only apply where the securities were not registered in that persons name. The Committee thought that the declarations should be included in a special register, available for inspection, and such details should be included in the annual return. The Committee further considered that 'these provisions should as a deterrent apply to bearer securities although detection of a breach would be difficult'.(183)

Whilst recognising that there would inevitably be cases where there was non-compliance, the Committee thought that the ennactment of such obligations would discourage persons 'who would at present see no danger in concealing their identity' from continuing in this vein. Furthermore, it was recommended that where there had been no or a deficient declaration or votes were exercised by a person who had not made a declaration there should be a fine of £500 and, or six months imprisonment, on conviction.(186)

Before the 1947 Companies Bill was drafted, Lord Cohen and a number of other'experts' devoted several months attempting to devise a mechanism for full disclosure of beneficial ownership, with the Board of Trade,(185) However no scheme that was sufficiently comprehensive or fullproof could be devised. With regard to the proposed requirement that 1% shareholders should disclose, it was known that the Board of Trade favoured this, and this recommendation was included in the Bill. However it met very great criticism because of the amount of work that it would impose on company officers and the fact that it could be easily ignored, or circumvented by using foreign nominees. Furthermore the relevant clauses in the Bill were incredibly complex, involving some five pages of

small print. The Board of Trade in its Notes to the Jenkins Committee stated that 'it was thought that even lawyers would find it difficult to understand, and that methods of evasion could be easily devised'.(186) Furthermore, evidently Lord Jowitt, the Lord Chancellor, and Sir Stafford Cripps the President of the Board of Trade considered that it was just not possible to devise any system for the disclosure of beneficial ownership which would not have the fatal flaw or easy evasion. The Board of Trade, in its Notes to the Jenkins Committee stated, 'both the Government and the Opposition were generally in favour of disclosure, but confessed themselves defeated by the difficulty of legislating'.(187) In the result the only recommendations of the Cohen Committee on nominee disclosure, except those in relation to directors which will be examined later, that were enacted in 1948 were those relating to the powers of the Board of Trade to investigate the ownership of securities, which will be discussed here, for the sake of clarity.

(b) INSPECTIONS INTO BENEFICIAL OWNERSHIP OF SECURITIES

By virtue of section 172(1) 'where it appears to the Department of Trade that there is good reason to do so', they may appoint one or more competent inspectors to investigate and report on the membership of any company and otherwise with respect to the company for the purposes of determining the true persons who are or have been financially interested in the success or failure, real or apparent of the company, or able to control or materially to influence the policy of the company. Under subsection (2) the appointment of an inspector under this section may define the scope of the investigation in relation to the matters to be investigated or the period to which the inspection is to relate, or indeed both. Moreover the inspection may also be limited to 'matters connected with particular shares or debentures'. The Department of Trade and its predecessors have been extremely reluctant to exercise this power, as, we shall see later, they have been with the appointment of inspectors generally. It is most rare to find a case where the Department has used the powers accorded it under Section 172 alone and not in conjunction with one of the other sections relating to the appointment of inspectors.

Where an application for an investigation under Section 172 is made, in respect of particular shares or debentures to the Department, by not less than two hundred members, or by members having not less than one tenth of the issued shares, the Department of Trade must appoint an inspector, 'unless they are satisfied that the application is vexatious'. Under Section 172(3) the Board of Trade in their Notes, submitted to the Jenkins Committee stated that they had interpreted 'vexatious' as meaning 'foran improper purpose or without sufficient reason'.[188] The Inspectors appointment cannot exclude from the scope of the investigation any matter which the shareholders application seeks to have included, subject to the Departments holding that such would be unreasonable. The Department of Trades record with regard to appointments under Section 172(3) has been better than under its own discretionary powers of appointment.[189] On average

there are at least two appointments annually, in recent years, but often in conjunction with the more general inspection provisions in Sections 164 and 165.(190)
Mr Arthur Lewis M.P. asked the Secretary of State for Trade and Industry, what procedure the Department followed when it received applications under Section 172(3).
Mr Ridley M.P. stated that the application would be given due consideration and if the identity of the controllers of the company were unknown it would be normal to grant an inspection.(191) This perhaps illustrates the narrowness of the provision.(192)

The inspectors powers under Section 172 are as the Cohen Committee recommended wide and 'drastic';(193) subject to the terms of his appointment the inspectors powers will extend to the investigation of any circumstances suggesting the existence of an arrangement or understanding which though not legally binding is or was observed, or is likely to be observed in practice, and which is relevant to the purposes of the investigation. Moreover an inspector has the same powers under Sections 166 to 168, that those appointed under Sections 165 and 166, and which are discussed elsewhere, have.(194) It is also provided that the Department of Trade need not supply the company or anyone else with a copy of the inspectors report 'if they are of the opinion that there is good reason for not divulging the contents of the report or parts thereof'. However the registrar should be supplied with a copy if the Department is not of the opinion that there is not a good reason for publishing the information, or a copy of such parts as are unobjectionable on this ground.(195) It should also be noted that the cost of an inspection under section 172 is to be borne by the Department of Trade.

Apart from a full scale inspection the Department of Trade is given a less 'drastic' power under Section 173. Under this section where it appears necessary or that there is good reason, in the Departments view, to investigate the ownership of any securities and yet in their opinion it is unnecessary to appoint an inspector, they can require, whomever the Department has reasonable cause to believe to have been interested in those particular securities, or to

have acted as a solicitor or agent of someone who was in fact interested in the securities, to give them information 'which he has or can reasonably be expected to obtain as to the present and past interests in those securities and the names and addresses of the persons interested and of any person who acted or who is acting in relation to those securities'. For the purposes of Section 173(1) a person will be deemed to have an interest in a security if he has any right to acquire or dispose of it, or any interest therein, or to vote in respect thereof, or if his consent is necessary for the exercise of any of the rights of other persons interested therein, or if other persons interested in the securities can be required or are accustomed to exercise their rights in accordance with his instructions.(196) Failure to give information required under Section 173 or the giving of false information, intentionally or recklessly, is constituted an offence under section 173(3) with a fine of £500 and, or six months imprisonment.(197) It is difficult to determine how often the Department of Trade and its predecessors have used this potentially very useful section. In their Notes, submitted to the Jenkins Committee the Board of Trade stated that since its ennactment they had only utilised it on two occasions, and in both instances it was only invoked as an adjunct to an already existing inspection under Section 165(b).(198)

The criteria in both Sections 172(1) and 173(2) is that the Department of Trade, considers that 'there is good reason' to initiate an inspection or investigation. The Cohen Committee had recommended, however, that 'we think that the Board of Trade should have the power in any case where they are of the opinion that it is desirable in the public interest to ascertain by whom control of a company is exercised'.(199) In Recommendation (m) on page 45 of the Cohen Committee Report, it was again stated that 'if the Board of Trade considers it necessary in the public interest to investigate the ownership of shares in a company they may appoint an inspector to conduct such investigation'. The Board of Trade in their Notes to the Jenkins Committee stated that the Solicitor General during the passage of the 1947 Companies Bill concluded that it

was necessary to substitute the 'good reason standard' for that of the 'public interest' criteria in order to make it more easy for the Board of Trade to decide whether to initiate an investigation.(200) Exactly what the impact of this alteration in the drafting of the provision has had is a moot point. It is arguable that the Cohen Committee thought that there was a public interest in the disclosure of beneficial ownership generally, or at least when there was no equal or prevailing public interest against such.(201) It would seem however, that the Board of Trade and the sponsors of the 1947 Act, considered that the 'public interest' requirement of the Cohen committee was narrower than the 'good reason' criteria. The Government took the view that on this premise the Board of Trade should not have to wait until some grave circumstances had arisen' 'so that it could be said that it was in the public interest to mount an inspection'. The Notes of the Board of Trade given to the Jenkins Committee stated that 'the Solicitor General took the view that anything that could be said to be a good reason from a sensible point of view should be sufficient to warrant an inspection'.(202) In practice however the Board of Trade claimed 'they have not in fact found it necessary to make great use of their powers',(203) and it is doubtful whether an even more restrictive approach to these sections would indeed have been possible.

In the Board of Trades Notes, it was stated that the President of the Board of Trade regarded the objective of the provisions relating to nominee shareholdings in the Companies Act 1948, as threefold. These were

> 'first to ascertain ownership where it is a matter of national importance that such should be done; second to check improper dealings by directors in the securities of companies of which they are directors, which they could do by concealment; third to make the register of members more informative to companies and to the public. The first two, to ascertain ownership where it is nationally important and to check improper dealings can be done by the powers of investigation that are given in these clauses to the Board of Trade'.

The Boards Notes continued that in consequence it had been the policy and practice of the Board of Trade to interpret

the words 'good reason' in the same way and sense as 'in the public interest' as for example if it was suspected that a foreigner was attempting to obtain control over an essential British industry.[204] Thus in the Board of Trades view, and that of its predecessors, the 'criteria of good cause' must have a sufficient public interest element.[205] On behalf of the Board of Trade, Mr Dean in giving oral evidence to the Jenkins Committee stated that the Board had taken advice on the interpretation of these sections and took the stand that for an investigation there must be some question of public interest as distinct from the interest of an individual.[206] In the view of both the Cohen Committee and also the declared policy of the Board of Trade and its successors it would seem that the investigation of 'improper transactions', which would include insider trading, would come within the composite criteria of 'good cause and public interest'.

The Cohen Committee realised that if the investigatory powers were to be at all meaningful it would be necessary to provide the Government with some means, preferably of an administrative nature, to prevent changes in ownership of the securities under investigation.[207] Thus it is provided in Section 174 that where in connection with an investigation under Sections 172 and 173 it appears to the Department of Trade that there is difficulty in finding out the relevant facts about any securities, and that difficulty is due wholly or in part to the unwillingness of the persons concerned to assist the investigation as they are required to, the Department may by order make a number of orders subjecting the securities to a variety of restrictions. These restrictions are listed in Section 174(2) and include, that any transfer of those securities, or where such are unissued, any transfer of the right to have such issued, and any issue, will be void, that no voting rights with regard to the securities are to be exercised, that no further securities are to be issued in pursuance of a right stemming from the holding of securities already issued, or in pursuance of any other offer to the holder, and except where there is a liquidation that no money is to be paid out on those shares.

Where the Department of Trade makes such an order, or

where it refuses to lift such once made, any person aggrieved thereby may apply to the Court. The Court can direct that the order in whole of in part should cease to have effect. Even if the Court or Department lifts the restrictions on transferability it is still feasible for the restrictions on further issues of securities and payments of money to remain intact, under Section 174(4). If the corporation disregards such an order and does issue securities or pay out money, the company and every officer in default is liable on conviction to a fine of £500, under subsection 6, and any person who exercises or purports to exercise any right, when to his knowledge such are subject to restrictions, under the section, or who being the registered holder fails to notify another who he knows to be unaware of the restriction and who is exercising the right, is liable to a fine of £500 and or six months imprisonment. However no prosecution can be brought without the consent of the Department of Trade.

In the Board of Trades evidence to the Jenkins Committee it was stated that Section 174 had never been used, and this has remained the case until relatively recently. However in the last couple of years there have been several instances where Section 174 has been used to some effect. In July 1975 the Secretary of State for Trade appointed Millett Q.C. and Bowie, to investigate the ownership of Darjeeling Holdings.(208) The Inspectors discovered that some 28% of Darjeeling's securities were held by Fireball a company registered in the Isle of Man. There was a complete lack of cooperation as to who in fact was the beneficial owners, and Mr Peter Shore, the Secretary of State, made an order under Section 174, in effect freezing the 28% holding.(209) Because of the inconvenience that this caused, it was reported in the press some four months later that the officers and accountants of the companies concerned had handed over the required documents and details to the Inspectors.(210) A similar order was issued with regard to some 464,500 shares in Ashbourne Investments, by Mr Shore, under Section 174. Again the Inspectors who had been appointed to investigate Ashbourne Investments could not find out who these securities belonged to, as they were registered in the name of

Samuel Montagu (Nominees) for a Swiss bank.[211] Obviously these are very useful powers and could be used with great advantage in 'cracking' nominees, and assisting in the regulation of any future laws on insider trading.

(c) LEGISLATIVE PROPOSALS

The Jenkins Committee asked for evidence specifically on whether the practice of nominee registration was valid, and if a general scheme of beneficial disclosure would be advantageous. The answers that the Committee received were as interesting as they were diverse. The majority approach was that expressed by the Accepting Houses Committee and Issuing Houses Association; 'the administrative advantages of the nominee system are so great that any attempt to do away with it would seriously affect the efficient working of the City's day to day business'.(212) Even the Board of Trade acknowledged that 'it seems widely recognised that the nominee system confers substantial advantages, and that there is a real risk that foreign business might be lost if there were a universal obligation on nominees to disclose true beneficial ownership'.(213) Some of the reasons advanced for their retention were less than convincing. Mr Lawson giving oral evidence for the Committee of London Clearing Banks thought that nominees were beneficial, for allowing employees to conceal their true earnings, and to allow competitors to obtain a company's balance sheets. The Estates and Agency Company Ltd, thought that nominee registration was useful as it allowed a director where he wanted to 'dispose of a large number of shares for purely personal reasons' to do so without causing harm to the company, by other investors following him.(214)

There was evidence submitted calling for the abolition of nominee registration, however. For instance De La Rue Company Limited advocated legislative prohibition of nominee holdings, even at the expense of administrative inconvenience.(215) Apart from the question of whether nominee registration should be abolished, there was controversy as to whether there should be a mandatory disclosure of all beneficial ownership or whether it would be sufficient to require disclosure only where there was an element of control. Apart from with regard to the disclosure of directors shareholdings, which will be examined later on, the general consensus of opinion was against mandatory nominee disclosure. For example the Council of the Law

society stated that there was no general principle in English law that required an agent to disclose who his principal was or indeed for a principal to do such, and it was emphasised that 'the Council do not accept that it is in the public interest to change this principle'.[216] Indeed Mr Ockleston, for the Council of Associated Stock Exchanges thought nondisclosure of beneficial ownership was un-objectionable even when a person was attempting to obtain control.[217] A number of witnesses emphasised that securities were property, and as with other forms of property should be allowed to be dealt with in confidence.[218] However, a number of witnesses took the point raised by Lord Jenkins, that securities were a special kind of property in that 'in a way they are like playing cards, if you have got more than a certain number in your hands you may get an enormous advantage'.[219] The Bank of England for instance, in its evidence, stated that 'it appeared from the Governors discussions in the City that there is a considerable volume of City opinion, which whilst recognising the difficulties, would welcome some workable scheme, if one could be devised, which required declaration of interest, when beneficial interest in the capital of a company reached a certain level, which might well be considerably higher than that suggested by the Cohen Committee'.[220] The Accepting Houses Committee, which had opposed full beneficial disclosure, on the grounds inter alia of banking secrecy, thought that disclosure of control status was necessary if investor confidence was to be preserved. The Faculty of Advocates thought that it was necessary from the standpoint of minority shareholders to be able to determine whether their directors were in the control of someone else, and similar sentiments were expressed by the Board of Trade itself.[221] The Board of Trade thought that the extended definition of director in certain sections, such as sections 195 and 200 would comprehend controllers. On the other hand the Chartered Institute of Secretaries thought that these extended definitions were so uncertain and vague as to be practically useless, and indeed the Board of Trade, admitted as much,[222] but thought that it might have

some deterrent effect.

The Jenkins Committee, did look at the Cohen Committee's suggestions for individual declarations in some detail, despite the general opposition to such, on principle. The bulk of evidence received on this point was characterised in a remark by Mr Lawson, speaking for the Committee of Clearing Banks, 'I do not think that is a runner, Sir, if I may say so'.(223) The amount of extra work, the complexity of definition and administration and the difficulties of enforcement were in the main considered too much. Certain witnesses thought the answer would be, a declaration of status, with the provision of a power to the directors in particular cases to demand further details.(224) Messrs Revell and Feinstein, thought that 'it is probably impossible to suggest a registration procedure which cannot be evaded by a determined person, but this is no reason for not trying to obtain as wide a declaration of beneficial ownership as possible. 'They also drew attention to conceiving of the register as an instrument designed to prevent fraud. Although by disclosure Revell and Feinstein, thought that 'it is possible to discourage those that will only be dishonest if it is not too dangerous' and that a disclosure scheme would have the advantage that anyone who violated it, if detected would in the words of the Cohen Committee(225) 'be put upon their defence and start that defence under a handicap which will certainly be severe'. It is also interesting that unlike the other witnesses, Revell and Feinstein pointed out, that as nominee registration was for administrative convenience in most cases, most principal would not object to the disclosure of their identity. No empirical evidence on this was however given.

With regard to disclosure of shareholdings of 'control' significance, as has been stated there was wide agreement that such would be beneficial provided that the disclosure threshold was not so low as to generate the same kind of problems that applied to the disclosure of beneficial ownership generally. There was considerable discussion among the various witnesses giving evidence to the Jenkins Committee as to where the appropriate disclosure threshold should be drawn.(226) Most supported the figure of

ten per cent, as in the words of the Second Secretary to to the Board of Trade', ten per cent is a compromise between a too small figure, where there is no justification or requirement for disclosure, and a too high figure where disclosure would be too late'.[227] The Board of Trade made it clear that this was directed towards 'claudestine-creeping control'. Professor E.V.Morgan, of the University of Wales, although sceptical of how warehousing[228] could be prevented, with a threshold of ten per cent thought that the percentage should refer to a class of securities and not the entire capital.[229] There were representations for a five per cent threshold in certain instances,[230] others mentioned fifteen per cent,[231] and twenty per cent,[232] Revell and Feinstein thought that the threshold should be set at a £1000 holding of the nominal share capital, and not of voting rights or the market value. This would in their view amount to about a 5 to 10% holding of voting capital, on the basis of their survey.

Revell and Feinstein also considered the obligation to disclose should be placed on the nominee and not upon the beneficial owner or registrar. The Board of Trades view on this was ambiguous, as the Permanent Secretary, Sir Richard Powell merely spoke of the disclosure obligation being on 'the individual', although another officer of the Board of Trade did say that the disclosure obligation should be on the person controlling ten per cent of the voting rights.[233] The Scottish Bank General Managers and the Committee of London Clearing Banks thought that the obligation should be on the beneficial owner.

Concern was expressed that because of the difficulties in enforcement disclosure of 'control holdings' could act as a snare and mislead shareholders. Sir Richard Powell, the Board of Trades Permanent Secretary, whilst acknowledging the difficulty of enforcement thought that by placing a strong penalty on default there would be a great impetus to disclose.[234] The majority of witnesses whilst agreeing to the difficulties of comprehensive enforcement thought there would be substantial compliance with a legal disclosure obligation.[235] The Federation

of British Industry, opposed legislation on the ground that enforcement would be impracticable, because of the use of foreign nominees, bearer securities, and mutiple nominees. Furthermore it was stated that it would discourage foreign investment through the share deposit system, under which such organisations as the Guarantee Trust of America and SICOVAM, hold blocks of securities in British companies and issue depositary certificates which are freely transferable as bearer documents. The British company cannot go behind the company's name in which such are registered. But as Professor Morgan stated 'any law can be evaded and is evaded to some extent, no law is 100% effective, unfortunately'.(236). Nonetheless, as the Federation of British Industry stated 'it is the very cases where disclosure would be beneficial that it will not be made'. It is important to remember, however, that a person who is seeking to gain control of a company will inevitably at sometime have to 'show his hand' and thus expose himself to the penalties foe non-compliance. The British and Scottish Chambers of Commerce thought here the appropriate remedy would be deprivation of voting rights, in total, or in excess of the disclosure threshold. This was opposed by the Clearing Banks on the ground that the proposed legislation would be extremely complex, and if the threshold was based on a percentage of share capital, the beneficial owner might well contravene the law inadvertently.

A number of witnesses were in favour of the directors being given the power to demand details of beneficial ownership in particular cases,(237) and the Economist recommended that the shareholders by ordinary resolution should be given the power to demand directors to make such inquiries.(238) However both Lord Piercy and Professor Morgan, in evidence thought that the possession of such powers placed the directors in an invidious position, and thought that it would be preferable to expand the scope and availability of official investigations. A number of other witnesses thought that it would be appropriate to provide the directors of a company with the power to require or ask the Board of Trade to make inquiries, under its powers for

the investigation of share ownership.[239] On the other hand many pointed out that investigations, because of their inevitable delay provided scant protection.[240] The Jenkins Committee was obviously impressed by the amount of evidence that it had been given on the question of nominee registration, and in particular the general view that such served a practical and beneficial purpose. However at the sametime, although seeming to accept, that complete beneficial disclosure was impossible or impractical, the Committee thought that there should be disclosure obligations in the case of directors, which will be discussed later, and in the situation where persons are acquiring or have acquired a certain control status. It is not without interest that the Committee was impressed by the American evidence that was submitted to it, to the effect that Section 16(a) had received a 'remarkable degree' of compliance.[241] The Jenkins Committee also took the point that someone attempting to obtain control through stealth would inevitably have to show his hand, and provided the penalties were strong enough this should act as a deterrent. Furthermore the principal would be in the hands of his nominee and open to blackmail and coercian. Of course this reasoning is based on disclosure of control and not disclosure of insiders transactions, as in the latter there is no inevitability in the true status emerging. In the result the Committee recommended that Section 195 of the 1948 Companies Act should be amended so as to require the beneficial owner of ten per cent or more of the equity capital or any class of equity shares,[242] or of any other class conferring ordinary voting rights of a company whose shares, or any class of such, were quoted on a recognised stock exchange, to disclose his identity and report his subsequent transactions. This new provision in the Committee's view should not apply to directors as they would be under a separate duty to report all their transactions in the issuer.[243]

(d) STATUTORY PROVISIONS REQUIRING DISCLOSURE OF BENEFICIAL OWNERSHIP

The result of these recommendations was the enactment of Section 33 of the 1967 Companies Act.(244) The complexity of the section equalled the worst fears of those pessimistic witnesses who had given evidence to the Jenkins Committee.(245) Basically Section 33(1) provides that holders (246) of substantial interests in securities, which are defined as holdings of ten per cent, or more, of the nominal value of any class of shares carrying unrestricted voting rights, must on the occurrence of certain stipulated events, notify the company in writing. This provision applies however only to a company 'of which there has, as respects the whole or any proportion of its share capital, been granted a quotation on a recognised stock exchange'.(247) It should be noted nonetheless, that the obligation to report does not only extend to the class of securities so quoted.

The events upon the occurrence of which the shareholder must notify the company, are where a person becomes interested in ten per cent or more of the nominal value,(248) of the class of shares with unrestricted voting rights, where that persons former interests and acquired interests amount to ten per cent or more, where having already become a ten per cent shareholder he acquires or disposes shares of that same class, his holding still remaining above ten per cent, or where already having ten per cent or more of the relevant share capital he suffers a decrease in the nominal value of his interest in the relevant share capital so that his interest is reduced below ten per cent. The notification to the company must state the occurrence of the event and the date upon which it occurred and according to the circumstances of the case the number of shares comprised in the share capital, specifying such, in which immediately after the occurrence of the event the declarant is interested, or the fact that after the event he is not any longer so interested in the shares. Moreover it is necessary for the notice to identify the declarant by name and address, and where he is a director of the company state that it is given in pursuance of Section 33.(249)

It should be noted that contrary to the recommendations of the Jenkins Committee, directors of the company are required to comply with Section 33, as well as with Section 28.[250] This underlines, again the fact that the disclosure mechanism under Section 33 is concerned with control both actual and potential and not with insider trading. Indeed the price at which the transaction was effected is not required to be stated under Section 33, although of course, given the information that is required it would not be too difficult in most cases to find this out. The same notice provisions apply when part of the company's share capital is first granted a stock exchange quotation, or where shares are enfranchised with unrestricted voting rights.[251] Under subsection (5) it is provided that the notice must be communicated to the company within fourteen working days of the occurrence of the event giving rise to the obligation. This time period commences, if at the time of the occurrence of the event giving rise to the obligation the person under the obligation knows of the occurrence of the event the day next following that on which the event occurs.[252] Otherwise if the occurence of the event was not known then the fourteen day period commences 'with the day next following that on which the occurrence of the event giving rise to the obligation comes to his knowledge'.[253] It is interesting that the Jenkins Committee had recommended that the notification should be within seven days 'of such transaction coming to his knowledge',[254] and the Cohen Committee thought ten days, but did not state whether the declarant should know or not. The Cohen Committee merely stated that the disclosure was to be activated by the change,[255] apparently whether the owner was aware of such or not. Under the Section, it would seem that the declarant should have actual knowledge and negligence is not sufficient. If this interpretation is correct, it would seem unsatisfactory, as there should be a duty upon persons having substantial investments in a company to exercise at lease reasonable care in ensuring compliance with Section 33.

The provisions in Section 28 of the 1967 Act which delineate the meaning of directors interests, and which will

be discussed later on, are made applicable to substantial shareholders by virtue of Section 33(4). However there are a number of modifications that should be mentioned here, with regard to the applicability of Section 28 to the obligations imposed under Section 33. For instance debentures, query, convertible debentures, are excluded from the purview of Section 33. A number of stipulated 'interests' comprehended in Section 28, are specifically excluded from Section 33; for example an interest for life for himself, or another, of a person under a settlement, in the case of which the property comprised therein consists of, or includes, shares being a settlement with respect to which the settlement is irrevocable and the settler has no interest in any income arising under or property comprised in the settlement,(256) is excluded from Section 33. Likewise the interest of a person arising by holding shares as security for an advancement of money in the ordinary course of business is excepted.(257) Moreover, under Section 33(4)e 'any such interest, or interests of such class, as may be prescribed...by regulations made by the Department of Trade by statutory instrument' are excluded, and 'a definition of a class of interests for the purposes of regulations made under paragraph (e) may be framed by reference to any circumstances whatsoever'.(258) Among the 'interests' that the Department of Trade had excepted from Section 33, are the interests of a United Kingdom corporation, engaged in banking or insurance, which under the rules made under the Public Trustee Acts 1906 and 1957 is entitled to act as a custodian trustee, and likewise various subsidiaries of such companies. Similarly interests of a company acquired as a result of the acceptance of a conditional offer made by the corporation as part of a takeover, made to all the shareholders or all a class thereof, being interests subsisting while the condition of the takeover offer remains unfulfilled, have been excepted.(259)

The penalties, which both the Cohen Committee and Jenkins Committee should be severe, so as to act as a deterrent,(260) are stipulated in Section 33(6). A person who fails to comply with the disclosure obligations, or who knowingly,

or recklessly make a false statement is liable on summary conviction to a fine of £200 and, or three months inprisonment and on indictment an unspecified fine and or two years imprisonment. Prosecutions can only be instituted with the consent of the Department of Trade or Director of Public Prosecutions.

In accordance with the recommendations of the Jenkins Committee [261] section 34 provides that every company subject to section 33, must keep an indexed register in which against the name of the substantial shareholder the date and required information in chronological order, must be recorded, within three days of the company receiving the notice.[262] The Register of substantial shareholders must be kept where the register of directors interests is located, and is to be available for inspection and copying on the same terms as the register of members.[263] Where there is default in complying with the requirements of this section the company and every officer in default are liable to a fine of £200 and a default fine, and the Court may be approached for an order compelling inspection or the provision of a copy.[264]

The power to inspect the register is qualified under Section 34(5) insofar as there is no right to inspect information with respect to a company for the time being entitled to avail itself of the provisions in Sections 3(3) and 4(3) of the 1967 Companies Act. These provisions permit a company to seek a dispensation from the Department of Trade, allowing it to withold from its accounts or from the statements required to be annexed to the annual return information about a subsidiary or an associated company which is incorporated outside the United Kingdom or carries on business outside the United Kingdom. Without the exemption in Section 34(4) it would have followed that if the information was open to inspection there would be publication of the fact that the company keeping the register was a subsidiary or an associated company with a company that had been granted a dispensation. This would of course nullify the object of the dispensation which was to prevent publication of such a relationship.[265]

The principle in Section 117 is reinforced as in the

case of the register of directors interests, under Section 29(6) by Section 34(4) which provides that the company shall not by virtue of anything done in compliance with the section, be affected with notice or put upon enquiry as to the rights of any person in respect of the shares.[266]

Whilst Section 33, has in the main appeared to work reasonably well, and has facilitated the identification of controllers and transactions by those persons in an influential position in the company, particularly by the press,[267] there has still been considerable concern expressed about nominee registration and the attendant possibilities for undersirable practices. During the Conservative Governments review of company law, for the purposes of reforming legislation, a number of questions were asked in the House of Commons as to whether the Department of Trade and Industry would consider recommending abolition of the practice of nominee registration altogether.[268] It is not without interest that a number of politicians took the view that 'there is no doubt at all that nominee shareholdings does offer a particularly appropriate vehicle for skulduggery'.[269] Sir D.Walker-Smith M.P. specifically drew the attention of the Secretary of State for Trade and Industry to the possibilities for undetected insider trading that nominee registration afforded.[270] Whilst admitting that nominee registration was a matter being examined the Secretary of State considered that nominees were not necessarily used for improper purposes. In the Governments subsequent White Paper, it was stated that 'there is nothing inherently wrong with the practice of holding shares through nominees...Furthermore there is a large and complex area of common law and trusts which would be involved in any attempt to forbid the practice even if that were thought desirable'.[271]

After consideration of the public concern about nominee holdings and alleged abuses, the Government did consider that legislative action was needed with regard to one particular aspect, that of 'warehousing'.[272] The difficulty had been caused by the absence of any aggregation or acting in concert provision in Section 33. Of course the broad definition of interests might dictate disclosure where

a person utilised nominees, but not where associates, or members of his family acquired in their own right. The Government announced its intention of dealing with warehousing in two ways, firstly by lowering the disclosure threshold, down to at least five per cent, and secondly by reducing the period of time in which notification should be made 'to the minimum consistent with practical operation'.(273) Of course by lowering the disclosure threshold, it would be necessary to involve more parties, if control was the objective of the operation, and thereby risk a greater exposure to detection.(274) The White Paper also accepted the recommendation of the Jenkins Committee that directors should have the right to demand details of beneficial ownership where they suspected that the company's securities were being 'warehoused'. However it was admitted that 'an enquiry which ultimately leads to a nominee acting for a person overseas is unlikely to get any further, but even that information may be inferentially if not directly useful.(275)

Prior to the publication of the White Paper, the Stock Exchange had published a memorandum entitled, 'The Views of the Stock Exchange on Company Law Reform' (276) The nominee problem was discussed in the context of the regulation of insider trading.(277) Because it was difficult to determine whether securities were in fact being held by a nominee the Stock Exchange thought it would be impossible to prohibit such.(278) However in the view of the Stock Exchange and also the Take-over Panel,(279) the police should be given the power to call for details of beneficial ownership, if indeed insider trading was made a criminal offence as they suggested. The Stock Exchange, following the recommendation of the Cohen Committees thought that a person declaring his substantial interest should be obligated to state who his nominees in fact are.(280) Moreover the Stock Exchange(281) pointed to the inadequacy of Section 33, in failing to identify control concentrations of more than ten per cent that were held by members of a group of individuals or companies. Thus in their view 'section 33 should be extended to cover the acquisition and disposal of an equity holding of the relevant size be persons whether natural or corporate who are acting in concert with each

other'. This recommendation was reiterated in a letter to the Department of Trade and Industry, from the Stock Exchange Council after publication of the White Paper.(282) The Council also pointed out, in their letter, that the reduction of the disclosure threshold to five per cent could create difficulties for Stock Exchange member firms, and an exemption for Jobbers was urged, provided such was acting in the ordinary course of business.(283)

Both the Confederation of British Industry,(284) and the Wider share Ownership Council,(285) endorsed the approach of the White Paper with regard to nominee shareholdings. Although it is interesting that the Wider Share Ownership Council emphasised that whether a particular instance of warehousing was undesirable or not depended upon the circumstances of the case. The Company Law Committee, of the British Section of the International Commission of Jurists, Justice, in a Commentary to the White Paper(286) affirmed the notion that every company should have the right to know whom its controllers are. The Committee thought that the company should have the right to require shareholders to disclose the names of any person who is entitled to give them instructions on the exercise of voting rights. The Committee also thought that nominees should be required to inform the company of their status, and that they should, provided they were not trustees of ordinary family settlements, have to disclose the identity of the beneficial owners on the company's request. Unfortunately the Committee did not elaborate on these suggestions and explain how such could be made to work, in view of the unanimous rejection of such an approach by the Cohen and Jenkins Committees. The practical difficulties were fastened upon by the City of London Solicitors Company, in their Report on Insider Trading.(287) Whilst appreciating that insider trading laws would be almost impossible to enforce in many cases where nominees had been used, the Committee thought that a mandatory disclosure scheme was unworkable, and thought that the suggestion to deprive beneficial owners of all their legal rights to control their securities, placed in the hands of nominees was too extreme, purely in the context of anti-insider

trading regulation.

The promised 'important provision...relating to nominee shareholders and...warehousing' was introduced by the Secretary of State for Trade and Industry, Mr Peter Walker,(288) in the form of Clause 18 of the Companies Bill 1973. The philosophy behind Clause 18, was that of the White Paper. Nofifications of substantial shareholdings and changes in such were to be required within three days,(289) instead of fourteen. It is somewhat disturbing that the Secretary of State evidently thought that the present noficication period was twenty-eight days.(290) Furthermore Mr Peter Walker evidently thought that Clause 18 required notification to be made to the Stock Exchange 'where it would be put on the Stock Exchange board and become public knowledge'.(291) The Bill was completely silent on this, in the context of Section 33 disclosure.

Clause 18(2) would have reduced the disclosure threshold to five per cent, and empowered the Secretary of State to reduce it even further by regulation under Statutory Instrument. Whilst Mr Rodgers M.P. criticised the five per cent threshold as too high, during the Second Reading of the Bill, The Secretary of State made it clear that if 'undersirable practices continued the threshold would be lowered.(292) The disclosure mechanism in Clause 18, was reinforced by Clause 19, which provided that a company to which section 33 applied, could by notice in writing require any member of the company within such reasonable time as is specified in the notice to inform it whether he holds the securities as a trustee and to indicate, if such be the case, as far as he can the person for whom he holds the securities, either by name or by other particulars sufficient to enable those persons to be identified and the nature of their interest. Under the terms of sub-clause (2) if the company serves such a notice and is given details of whom the registered shareholder in fact holds the securities for, the company can serve a similar notice upon that person so as to determine if indeed he is the beneficial owner or a mere trustee for someone else. Furthermore the company would have been empowered to serve

a notice on any member of the company requiring information as to whether any of the voting rights carried by any shares comprised in the relevant share capital of the company held by him are the subject of an agreement or arrangement under which another person is entitled to control his exercise of those rights and if so to give particulars of the agreement or arrangement and the parties to it. Whenever a company received information from a person in pursuance of a requirement imposed under this clause, the company would have been under an obligation to inscribe against the name of the member concerned in a separate part of the register of substantial shareholders, kept under Section 34, the fact that the requirement to give information was imposed by virtue of the company's exercise of its statutory powers, the date upon which it was required and the information received thereby. The same rights of inspection and copying that apply to the register of substantial shareholders would have applied to this part of the register. Failure to comply with a request for information of the intentional or reckless making of a false statement, bore a penalty of two years imprisonment, and or an unspecified fine, under Clause 19(6).(293) The person to whom the request was directed could escape, however, if he could establish that the required information was already in the possession of the company, or that the request had been vexatious and frivolous. Furthermore, and not without interest, Clause 19(8) provided that a person would not be bound to comply with a request, if he had sought and obtained the exemption of the Secretary of State, who could only grant such an exemption after consultation with the Governor of the Bank of England, and on being satisfied that on the basis of the applicants written undertaking, special circumstances existed justifying an exemption.

How effective this provision would have been in 'cracking nominees' is an open question. Mr Rodgers M.P. considered that Clause 19 was full of loopholes and was particularly concerned that information about the principal need only be given to the extent that the nominee was able to give it. This was of course

exceedingly vague, and did not necessarily override the nominees duty of confidentiality, or impose a duty of enquiry upon him. Furthermore concern was expressed to the vagueness of the 'vexatious and frivolous' exception.(294) Mr Meacher M.P. also voiced the opinion that Clause 19 would do little to frustrate insiders utilising nominees, particularly as it was the directors in whom the power to require disclosure was vested. The Secretary of State, emphasised that it was not the purpose of the provision to invade the secrecy of small shareholders, and it was evident from Mr Walkers observations that he intended Clause 19 to apply primarily if not exclusively in take-over situations.(295) Of course the Bill never became law, but it is thought that the approach embodied therein would still represent the Conservative Party's views.(296)

The subsequent Labour Government indicated that legislation would be introduced inter alia on the practice of 'warehousing'. The Report of a Working Group of the Labour Party's Industrial Policy Sub-Committee(297) although disproportionately concerned with insider trading, expressed concern about warehousing operations, and the practice of warehousers selling out their accumulated holdings to offerors, in a take-over situation, at a great capital profit.(298) Thus the Working Group recommended that the disclosure threshold should be reduced significantly, and below that of five per cent. Furthermore the 'Green Paper' recommended that 'the level is intended to apply to the total of shareholdings of persons acting in concert'.(299) The acknowledged difficulties of definition and administration would in the Working Groups view be appropriate matters for the proposed Companies Commission to deal with. The 'Green Paper' also expressed its support for full disclosure of beneficial ownership, although refrained from considering how this could be achieved. It is of interest that the Green Paper's main indictment of the nominee system was based on the degree of abuse that it had engendered. However, apart from an inferential allusion to asset stripping,(300) and the preoccupation of the Working Group with insider trading, no mention was made as to

what these abuses might be. Furthermore whilst the Green Paper produced no evidence of abuse, both the Cohen Committee and Jenkins Committee stated they had found 'no proven' case of abuse. Whilst there are obviously cases of abuse,[301] a balanced view must be taken.

The Stock Exchange, in their 'Comments on the Labour Working Party's Green Paper on the Reform of Company Law and its Administration'[302] expressed agreement with the Green Paper's approach to 'acting in concert' and disclosed that the previous Government had attempted to include such a provision in the Companies Bill of 1973, but had been frustrated by the problems of drafting such.[303] Great concern was expressed as to the reduction of the disclosure threshold would have on jobbers, and the Stock Exchange opposed the views expressed in the Green Paper on nominee registration, indeed the Stock Exchange's new TALISMAN system depends upon such.[304]

When the Labour Government introduced the Companies Bill (no 2) 1976, which was primarily a technical provision basically concerned with audit,[305] the Conservative Opposition placed considerable pressure on the Government to accept amendments directed at nominee registration and warehousing. Given the urgency that the Government felt to enact the Bill and the desire of the Opposition to get the amendments accepted the result was the implementation of the clauses in the 1973 Bill, Section 26 of the 1976 Companies Act ennacts Clause 18 of the 1973 Bill,[306] but has in addition two extra sub-sections, one incredibly tortuously drafted. Section 26(8) provides that a person who would otherwise be under a duty to notify the company under section 33, and section 26(1) of this Act will be excused if

(a) the nominal value of shares comprised in the relevant share capital of the company in which he was interested immediately before the event, and

(b) the nominal value of shares, so comprised in which he is interested immediately after the event, produce when each of them is expressed as a percentage of the nominal value of that share capital and (as so expressed) is rounded down, if not a whole number, to the nearest such number, the same result'.

The effect of this provision is that if a shareholder with

a present holding of 5.75% acquires another 0.24% he will not have to make a separate report for that acquisition, but in the case of an acquisition of 0.26% he would. The duty to report is based on 1% bands. Although this is probably salutary, the provision is most obscurely worded and is likely to cause considerable confusion. The other new clause, which reflects the recommendations of the Stock Exchange Council excludes from the reporting duty, shares held by a jobber in the course of his business.(307)

Section 27 reinforces Section 26, as Clause 19 did Clause 18 in the 1973 Bill. The only difference of substance between Section 27 and Clause 19 is that Section 27(4) extends the investigatory powers of the company to the person who the registered shareholder discloses as being interested in the shares. The company can send that person a similar notice, with similar penalties prescribed consequent on non-compliance, as a registered shareholder.

It is open to question how useful these provisions will be, although it is noticeable that certain companies have welcomed them and indicated a willingness to use section 27. Certainly this should be of assistance in Stock Exchange and other investigations. It should be noticed that as with the very similar Australian provision discussed later, the company can serve notice on any member and not only those reporting under section 33. There is however, weight in Professor Kahn-Freunds observation directed at the Cohen Committee's recommendations, that 'the separation of legal and beneficial ownership is a perennial problem of English Law. Henry VIII did not solve it, and it will hardly be solved this time round'.(308)

Finally, as certain companies suggested to the Jenkins Committee, it is possible for companies to tackle the problem of nominee registration through provisions in their own articles of association. For example in January 1975 the Lyle Shipping Group altered its articles so as to obligate all nominees to disclose their positions. This was reinforced by a provision allowing the company to refuse registration on transfer. In July 1976, the company announced that it was suspending the voting

rights of three anonymous shareholders, and were considering suspending the rights of a fourth if he did not identify himself.

Before examining how the United States have attempted to deal with nominees, the question of banking secrecy in the United Kingdom will be briefly discussed, and then the powers of the Inland Revenue Commission, which might provide a useful model in the field of securities regulation, and then finally how prepared the Courts are to penetrate corporate nominees.

(e) BRITISH BANKING SECRECY

Although the relationship between a banker and client is essentially that of debtor and creditor and thus of a contractual nature,(309) there are may occasions where a more exacting fiduciary relationship could be created,(310) and given the wide range of activities now encompassed by the typical banker, it would be dangerous to be over dogmatic about the nature of the relationship in any given instance.(311)

Whether a confidential relationship develops in equity or not, it is established that there is an implied contractual obligation between a banker and depositor that confidentiality of the account will be observed. Whilst this duty was thought of as a moral one, in the leading case of Tournier v National Provincial and Union Bank of England,(312) Banks L.J. stated that 'at the present day I think it may be asserted with confidence that the duty is a legal one arising out of contract.(313) However, this is not an absolute duty, and Banks L.J. in his judgement identified certain instances where the duty of secrecy would not apply. These are where disclosore is required under compulsion of law, where there is a duty to the public to disclose, where the interests of the bank require disclosure and where disclosure is made at the express or implied consent of the customer.(314) These exceptions would appear extremely wide, although it is interesting that the Younger Committee on Privacy,(315) stated that the banks assured them that 'they considered themselves under a legal obligation not to disclose their customers' affairs without authority and that they were conscious of the importance of confidentiality in the relationship'.

There are of course a number of legal duties to disclose information, but from the point of view of detection and enforcement, by the police, the most important duty is imposed under Section 7 of the Bankers Book Evidence Act 1879. This section provides that '...on the application of any party to a legal proceeding a court or judge may order that such party be at liberty to inspect and take copies of any entries in a bankers book, for any of the purposes of such proceedings. An order under this section may be made either with or without summoning the

bank or any other party...'. The crucial term 'legal proceedings' is defined in Section 10, as meaning 'any civil or criminal proceedings or enquiry in which evidence is or may be given and includes an arbitration'.

Given the apparent width of this section it might appear that there would be little problem in the United Kingdom in demanding information from bankers about their clients and their transactions. However, this is not the case in practice. The Courts from very early on refused to apply section 7 literally which would have in fact given either party to 'legal proceedings' the right to seek inspection of the others bank account even though such had little or no relevance to the case in point.(310) The courts were opposed to any appearance of 'fishing' for evidence, and it was held that the Act was merely procedural and did not create any new rights of inspection.(317) Where the request related to an account which was not prima facie that of a party to the suit, even greater caution was taken.(318) Apart from holding that Section 7 was only available where there would have been a right of inspection under the pre-1879 law, it was also held on a number of occasions that the right of inspection under Section 7 must be read as being subject to the normal rules relating to discovery of documents.(319) The Court of Appeal has laid it down that there has to be some evidence that the banking account had entries in it directly and solely relevant to the issues before the court.(320)

Whilst the position in civil litigation has been reasonably well delineated by the Courts until 1972 there had been no criminal case where the application of Section 7 to criminal procedings had been tested. This question did arise however in the recent case of <u>Williams and others v Summerfield.</u>(321) Lord Chief Justice Widgery referring to the earlier decisions stated that 'the courts had set their face against Section 7 being used as a kind of searching enquiry or fishing expedition beyond the ordinary rules of discovery'.(322) The Divisional Court emphasised that if the police initiated criminal proceedings simply for the purpose of seeking inspection of the defendants and others bank accounts with the view

of finding more evidence relating to different offences or even the one charged, that was wholly improper. In the present case the Court assumed that the summonses were 'genuine' in that they alleged offences that would be prosecuted, even though it appeared that the summonses had been obtained at an earlier stage than would normally be the case, at least partly so the police could utilise the procedure under Section 7.

The defendant in the present case argued that Section 7 should not be allowed to apply to criminal cases, because it placed a person in a position of perhaps having to incriminate himself. The Lord Chief Justice rejected this and stated that by both its intention and form the section definitely applied to criminal cases. However the Lord Chief Justice added, that 'it is an order which clearly must only be made after the most careful thought and on the clearest grounds. I would like to adopt the approach in civil proceedings were that practical'.(323) Of course in criminal proceedings there is nothing analogous to discovery. The only equation that the Court could draw was that of the power of the Justices to issue search warrants. Thus Lord Widgery stated 'that in criminal proceedings Justices should warn themselves of the importance of the step which they are taking in making an order under Section 7 and should always recognise the care with which the jurisdiction should be exercised, should take into account amongst other things whether there is other evidence in the possession of the prosecution to support the charge, or whether the application under Section 7 is of a fishing expedition in the hope of finding some material on which the charge can be hung'.(324) Lord Widgery added also that in view of the difficulty in exercising this particular jurisdiction the magistrate could always refer the decision to the High Court for determination.

With regard to the other exceptions to the bankers obligation of secrecy announced by Banks L.J. in the Tournier decision, there is a substantial degree of uncertainty. So far as disclosure in the public interest is concerned it would appear that some kind of 'serious

iniquity of a public character' is required.[325] Atlin L.J. in the Tournier case seemed to suggest that the bank could disclose where such would protect the legitimate interests of the bank, persons interested, or the general public, 'against fraud or crime'.[326] This would seem to be similar to the circumstances where an employee is at liberty to disclose wrongs or crimes by his employer despite his general duty of loyalty.[327] The third exception mentioned by Banks L.J. disclosure where it is in the banks interest, would appear to include instances such as where the bank sues for a debt that is owed to it, and thus has to disclose information relating to the account.[328] The final exception, that is where disclosure is at the express or implied consent of the client, creates few problems.[329] It should be noted that 'a banks duty of secrecy to its customers is not... confined to ordinary banking transcations, but would extend to all banking transactions which are effected for a customer ordinarily or extraordinarily'.[330]

It is disturbing, however, that many individual and organisations giving evidence to the Younger Committee on Privacy stated that in their experiences the banks had been lax in preserving confidentiality, and would give highly confidential information on occasions even over the telephone. Of course in a case of wrongful disclosure the client has remedies both in contract and tort, but in most cases once the disclosure has been made, it is unlikely that the civil law will provide the necessary recompense.[331] It is probably true that the legal rights of the bank to provide information does not reflect what occurs in practice. However, the protection is, at least in theory nonetheless there.

(f) THE POWERS OF THE INLAND REVENUE TO PENETRATE NOMINEES AND FOREIGN CORPORATIONS.

The sanctity of corporate personality and nominees in the vast majority of countries has been breached by taxation laws.[332] Obviously Governments have a direct interest in preventing the devices of their own legal systems being utilised for the purposes of depriving them of revenue. Whilst there are numerous provisions in the British tax laws to combat evasion, which are consistently being added to, attention will here be given to the powers of the Inland Revenue to demand information relating to nominees and foreign companies, primarily in the sphere of tax avoidance.[333] Talbot and Wheatcroft in Corporation Tax and Income Tax upon company Distribution,[334] aptly state that 'most tax avoidance schemes are complicated and most anti-avoidance legislation appears excessively so'. Attention will thus be focused on two main provisions that could arguebly prove useful models in the field of securities regulation, namely sections 453 and 481 of the Income and Corporation Taxes Act 1970.[335]

Under Section 453, it is provided that an inspector may by notice in writing require any person being a party to a settlement to furnish him within such time as any he may direct, not being less than twenty eight days with such particulars as he thinks necessary for the purposes of administering the provisions of the Act. The definition of settlement in section 454 includes any disposition, trust, covenant, agreement or arrangement. The leading case on this section is that of Wilover Nominees Ltd. v Inland Revenue Commissioners,[336] and the facts of the case are interesting from the point of view of the present discussion on insider trading regulation. The Revenue learnt that Wilover Nominees Ltd claimed itself to be a trustee of a settlement stated to have been declared by Marita Seigal. The Inspectors served a section 453 notice on the trustees requiring information as to the full terms of the trust and declaration, the address of the settler, the names and addresses of every person who has provided any assets to be held on the declared trusts apart from Marita Seigal, details of all acquisitions and disposals by the trustees

of assets related to the trust, copies of board minutes regarding matters related to the carrying out of the trust. The nominee company refused to give information under certain of the requirements, in particular that relating to transactions by the trustees and the minutes of the board meeting, and sought a declaration to this effect in the Chancery Division. It is interesting to note that the nominees claimed, inter alia that the requests were of a 'fishing nature'.

The Declaration was refused by Goulding J. on the ground that Parliament had given the Commissioners a very wide discretion in the information that they could demand, and that the information need not reasonably be related to the particular chapter of the Act to which the provision was made directly applicable, and could be extended so as to effect the statutory purpose of preventing evasion.(337) On appeal Stamp L.J. pointed out that the Revenue would not be in a position to determine whether the particular Chapter of the Act in question applied to the settlement if the Revenue were not allowed to ask questions about it,(338) until it had been established that the settlement was in fact one within the relevant taxing provisions. Indeed to escape, the taxpayer must establish that the Inspectors did not in fact think that the information was relevant, and thus they had been motivated by an improper purpose, or by muddled thinking. Goulding J. emphasised that 'Parliament... deliberately left it to the Commissioners and not the Courts to judge what disclosure is required in each case'.(339) The burden of establishing impropriety being firmly on the taxpayer,(340) in the present case the conduct of the nominees had been 'obstructive and grossly dilatory' and it was appropriate to dismiss their contentions.(341)

It is also not without interest that, as in a number of instances under section 7 of the Bankers Book Evidence Act, it was contended on the part of the nominees that the Inspectors questions were too far reaching and thus premature. This the Courts again rejected, and pointed to the great delay that would result if the Inspectors had to conduct their investigation on a gradual and step by step approach. Thus a comprehensive notice was unobjectionable.(342)

It was also thought that whilst the Inspectors had thrown the net widely, they 'are concerned to investigate not only the settlement effected by the declaration of trust but any wider arrangement of which it might be part.[343] This is therefore a provision of some width.

It is a basic principle of revenue law that the income of a person not resident within the United Kingdom which arises outside the United Kingdom escapes the British tax laws.[344] To prevent evasion of taxation by transferring income producing assets out of the United Kingdom, yet retaining an interest in them, and enjoying the income abroad, sections 478-481 of the Income and Corporation Taxes Act 1952 have been enacted.[345] Basically section 478 becomes operative whenever there is a transfer of assets whether out of the United Kingdom or not which has the effect of directly or through 'associated operations' providing that the income becomes payable to persons, including companies, resident or domiciled outside the United Kingdom. As a general proposition where any individual who is ordinarily resident in the United Kingdom has the power to enjoy the income of a person resident or domociled outside of the United Kingdom, such income is treated as his income for all purposes of the income tax regulations. Furthermore where property is transferred to a non-resident corporation whose shares are then settled on discretionary trusts with a number of beneficiaries ordinarily resident in the United Kingdom it would appear that each beneficiary could be assessed as a person having a power to enjoy the whole of the income which the non-resident company does not distribute.[346] There are also provisions that enable the Commissioners to exempt transactions where they are satisfied that the purpose was not to avoid tax.

Of particular interest are 'the powers of the Revenue to obtain information for the purposes of these sections which are unusually wide'.[347] Under the terms of Section 481 the Commissioners may by notice in writing require any person to furnish them within such time as they may direct, being not less than twenty eight days such particulars as they think necessary for the purposes

of this Chapter of the Act. Under sub-section 2 the particulars can include information as to transactions with respect to which he is or was acting on behalf of others and as to transactions which in the opinion of the Board it is proper that they should investigate for the purposes of this Chapter, notwithstanding that in the opinion of the person to whom the notice is given no liability for tax under this chapter arises. Information can also be demanded as to whether the person to whom the notice is given has taken or is taking any and if so what transactions of a description specified in the notice. In sub-sections (3) and (4) there are special provisions relating to solicitors and banks. The provisions relating to solicitors having its origin in Section 17(2) of the Finance Act 1939, gives effect to the usual attorney client privilege except that there is an obligation on the solicitor to disclose the names of parties involved. The provision relating to bankers, which has a history in Section 17(3) of the 1939 Act provides that there is no obligation on a bank to furnish any particulars of an ordinary banking transaction between the bank and its customers carried out in the ordinary course of business, 'unless the bank has acted or is acting on behalf of the customer in connection with the formation or management of any such body corporate or trust' as is stipulated in Section 481(3).[348]

There have been two recent and significant cases on this section and it is perhaps worth while taking a closer look at each. In the <u>Royal Bank of Canada v Inland Revenue Commissioners</u>,[(349)] the Commissioners served a notice under Section 414 of the Income Tax Act 1952, which is the same as Section 481 of the 1970 Act, on the Royal Bank of Canada, requiring it to give certain details of transactions and persons involved relating to the sales of gilt-edged securities carried out by the bank on behalf of a company incorporated in the Bahamas. Unknown to the Bank these were 'bond washing' transactions. This involved short-term trading in bonds, which in certain cases results in a slender profit at the expense of the Revenue, gilt-edged stock is purchased ex-dividend, often

through a nominee and then sold cum dividend during the period within which transactions in such stocks can quite correctly be ex or cum dividend.

The Commissioners demanded information as to the particulars of the manner in which the instructions for each sale were received and the names and addresses of the persons giving such instructions and other persons acting on behalf of the Bahamas company, also particulars of the agreement under which the transactions were carried out together with the names and details of the persons concerned and the name and details of persons believed by the Royal Canadian Bank and its officers and employees and agents to have control or have a beneficial interest in the Bahamas Company. Furthermore the name and address of the representative of the company who at a certain interview had discussions with a representative of the bank. The Royal Canadian Bank refused to comply with the notice and sought a declaration that they were not so bound to comply on the grounds that the transactions had been carried out in the ordinary course of banking and were thus protected by the predecessor of Section 481(1), furthermore that the only particulars that should under the section be demanded were particulars of transactions in which the addressee of the notice had been engaged and if any single question in the notice was outside the Commissioners authority, the whole notice was rendered bad.

These submissions were rejected by Megary J. who considered that the Commissioners powers as laid down in the statute were sufficiently wide to encompass the particulars mentioned in the notice. The only qualification was that the Commissioners thought that the information was necessary for the administration of the tax avoidance provisions. The notice need not be limited to information relating to the address but could properly extend to any information in the possession of the addressee. Furthermore the stipulated particulars in the section about which questions could be directed, were not necessarily exclusive. It followed that if it was established that the Commissioners thought that the information was necessary no objection could be made that the information demanded

was outside the statutory authority of the section. It is not without interest that Megary J. questioned the demand of the notice that any information as to the beneficial ownership or controllers of the Bahamas corporation in the possession of the Royal Bank of Canada, its officers, employees, agents and directors, must be given to the Commissioners, and wondered whether it was not too unduly burdensome and a viable practicability, particularly as the transaction in question had occurred five years previously. The Court stated that 'it seems to me that the wider the powers that Parliament confides in the Commissioners, the more important it is that the Commissioners should not exercise those powers in an unduely burdensome or oppressive way'.[350] The Commissioners contended that the words 'officer employee and agent' should be understood to refer to those who appeared to the Bank properly able to give the information. Of course the notice had not stated this, and the Court warned that in future the Commissioners should take greater care in the drafting of their notices, the more so because of the criminal penalties.[351]

The Court emphasised that Section 481(4) was a limited provision and only protected against disclosure of the particulars as to the transactions themselves and not to the names of the participants, the transaction must be such that it can be said to be an ordinary banking transaction and only transactions between the bank and its customers are protected, furthermore the transactions must be executed in the course of the banks ordinary banking business.[352] Megary J. held that the statutory protection in Section 481(4) of the banks confidentiality was no where near as extensive as their duty of secrecy. Whilst the evidence that was presented to the Court indicated that the transactions, involving the instruction to take delivery of the stock and place it in the banks nominees and to then sell it via a broker, delivery being against payment was a common occurrence throughout banking practice in the City. However there were certain unusual features in this particular case, such as those of bond washing and the fact that the Bahamas nominee company,

had instructed the bank to effect sales through a specified jobber, who was privy to the entire operation. Furthermore the fact that the customers were resident outside the United Kingdom was another unusual factor that should have placed the bank upon inquiry.[353] Furthermore the burden of proof was on the bank to avail themselves of the protection of the provision. The bank in the present case had failed to establish that the transactions in question were banking transactions let alone in the ordinary course of such. It was also the Courts view that even if certain requirements in the notice had been invalid the entire notice would not have fallen. In the result the Bank was held to be bound to make the required disclosures.

The other significant decision in this field from the standpoint of the present discussion, is that of Clinch v Inland Revenue Commissioners.[354] The plaintiff in the action was the London representative of N.T.Butterfield & Sons Ltd., a banking corporation incorporated in Bermuda. In 1970 the London Office had been incorporated into a wholly-owned subsidiary of the Bermudan Bank. This London branch's primary function was to advise customers, actual and potential about the advantages of transferring money to Bermuda and the general services of the Bank. The Inland Revenue in something of a trial move issued a notice under section 481 to the plaintiff requiring him as a former representative of the Bank in Bermuda to furnish them with details of transactions since April 1965 where he had acted for a United Kingdom customer in or in connection with any transactions or operations involving the formation or management of a foreign company, or partnership the creation or execution of foreign trusts, the transfer of assets to any foreign company, partnership, or settlement and the acquisition of any interest or option to acquire an interest in the share capital or loan capital of any foreign company, partnership, or settlement. In each case the name and address of the customer, or his agent all the particulars of the transactions in the plaintiffs knowledge, and the name and address of any other person to whom the plaintiff introduced the customer

for the purposes of completing or carrying out any such transactions or operations.[355] The plaintiff had not kept a separate file as to the information germain to Chapter III, and although there is no compliance with the anti-avoidance provisions in the Act virtually, and as a matter of practice dictated such. The plaintiff thus sought a declaration that the section did not empower the Commissioners to demand information from an intermediatory relating to unidentified transactions on behalf of unidentified principals and that the Commissioners in exercising their statutory powers had acted unreasonably and were being burdensome and oppressive.

The declaration was refused by Ackner J. Although rejecting the notion that the statute should be constued 'contra proferentum' the Revenue,[356] the Court emphasised that there must be the clearest authority before an invasion of the subjects liberty and freedoms are to be tolerated.[357] The Court was however of the opinion that Section 481 was sufficiently wide and clear to justify the questions asked in the notice. Furthermore the questions could quite properly be directed at such an intermediary as the plaintiff, as a stepping stone to establishing the relationship of other persons to various companies and trusts. Moreover it was emphasised that it rested upon the addressee of the notice to establish that the Commissioners had behaved improperly and that the information that they had demanded went beyond their powers, so that it was unduly oppressive and burdensome.[358] In Wilover Nominees v I.R.C., Goulding J. whilst agreeing with the sentiments of Ackner J. stated that 'it is equally vital for the Court...to ensure that the officers of the Revenue are able to exercise the full powers...with which Parliament has armed them for the performance of their difficult and often thankless duty under the law', as well as protecting the individual from executive abuse.[359]

The plaintiff adduced evidence that to comply with the requirements of the notice it would take himself and an assistant and also a secretary, with occasional assistance from a lawyer and accountant five months of full time

work. The Court whilst sceptical of this pointed out that the plaintiff under the terms of the notice was only required to give information which he had had access to and other than refreshing this once held knowledge there was no obligation on him to pursue enquiries beyond this and moreover there was no legal requirement for him to give notice to the various clients of the information that he had been required to disclose to the Commissioners, although such would in practice be done as a normal matter of banking courtesy. Even if the plaintiffs assessment of the time and expense involved was correct the Court accepted the submission of the Revenue that 'the plaintiff cannot pray in aid of his own failure to have this material reasonably available'.(360) To this extent the plaintiff had been 'the author of his own misfortune' as he should have prudently maintained the information now demanded of him. In the result the Court found that the plaintiff was bound to comply with the notice in its entirety with expedition.

Having regard to these provisions and the other similar sections in the tax laws(361) it is possible to find a model that could be utilised with great advantage in the field of securities regulation. As has been pointed out by Professor Gower,(362) there is much in the observation of Devlin J. in the Bank voor Handlel em Scheepvaart N.V. v Slatford,(363) that 'no doubt the legislature can forge a sledgehammer capable of cracking open the corporate shell; and it can if it chooses demand that the Courts ignore all the conceptions and principles which are at the root of company law. 'There have in recent years been significant advances in the powers of the revenue authorities to demand information, and not only from the object of the investigations, and this has been criticised by many as smacking of a 'secret police'(364) particularly where the information might be passed on to other Government departments.(365) There has also been a growing trend, internationally to override the traditional professional secrecy obligation in tax cases.(366) In recent years there has also been a marked increase in the attention given to offshore tax avoidance centres, and the curtailment of such facilities,(367) and not only by

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the British authorities.(368)

(g) LIFTING THE VEIL OF INCORPORATION AND INSIDER TRADING

Although it is not possible to enter into a protracted discussion of this area of the law,(369) it is necessary to point out its significance in the regulation of insider trading. A simple example suffices to illustrate the importance of this aspect of company law. Let it be supposed that an insider of X corporation, who is the controller of Y corporation deals on inside information through Y corporation. Disregarding the question of whether Y corporation is a tippee the question arises as to whether or not Y corporation could be said to be the insiders alter ego. The position is considerably more confused where a string of interrelated companies is utilised. This resolves itself into the question of whether the Courts would be likely to lift the corporate veil, or pierce corporate personality.(370)

There are of course a number of statutory and common law exceptions to the doctrine of separate corporate personality. The most significant exceptions by statute are probably contained in the tax laws, although there are a number of other instances,(371) none of which are particularly of interest to this present discussion. With regard to the common law exceptions Gore Browne states 'it is not possible to formulate any single principle as the basis of these decisions, nor are they all....entirely consistent with one another'.(372) Certainly it is true that the development of the law in this respect has been extremely susceptible to the public policy considerations of the particular age, and the Courts have shown a considerable degree of expediency and often a desire to do substantive justice, although not of course always. The cases have proceeded in isolation and each must be regarded as exceptional with regard to the fundamental corporation principle.

In a number of cases the momentum of the House of Lords decision in Salomon v Salomon (373) has proved too much for an encroachment(374) but where vital or significant public interests are at issue a bolder approach has been taken. For instance in time of war the Courts will examine who are the company's actual controllers so as

to detect enemy intervention.[375] Although a company is not an agent for the individual shareholders or controllers in general, where there is an express agreement to this effect the position is different.[376] The problems arise mainly in those cases where the Courts are asked to infer such an agreement,[377] and the courts will normally only do this where there is some compelling reason of public policy.[378] Where the Courts do find an agency relationship they are not as such piercing the corporate veil as the distinct corporate personalities remain intact.[379] The position is different where the Courts consider that one person or company is the alter ego of the other.[380] In the latter case the company concerned would have to be 'a facade concealing the true facts', or a shell, with identity of interest.[381]

The Courts will be prepared to penetrate the veil where the company was formed for a fraudulent purpose or as a sham.[382] It is a well tried principle of equity that a statute cannot be used as an engine of fraud, as neither can a legal principle, thus corporate personality will be penetrated where the corporation is 'a device and a sham, a mask which (the defendant) holds before his face in an attempt to avoid recognition by the eye of equity'.[383] The Courts have also been prepared to examine the inter-relationships of holding and subsidiary companies, particularly in the context of agency. It would seem that the Courts have by and large been more prepared to find an agency relationship or an alter ego, where the controller has been a corporation rather than an individual. Professor Gower considers that this might indicate an awareness of a group concept.[384] It is important to remember, however, that the mere fact that one company is a subsidiary of another even a wholly owned subsidiary is not of itself sufficient to make the subsidiary an agent of the holding company.[385] Although it has been contended, that in certain instances the company is a trustee of its property or certain rights for its members beneficially, such has rarely been accepted.[386] Whilst it is unquestionably possible for the company to act as trustee of certain

property for a beneficiary class which may indeed constitute the members of the company, what is certain is that the mere relationship of member and company does not without more involve a trust relationship with regard to the corporate property.(387) Where ratification of corporate acts is in question, certain Courts have taken a more realistic stance and have treated an agreement by every person entitled to vote as the equivalent of a resolution in general meeting.(388) Similarly as with enemy status the Courts will examine where the business control is resident in establishing the location of the company's seat for taxation.(389)

The Courts with regard to criminal, quasi-criminal and tortious acts have also been prepared to look beyond the corporate form.(390) This is a complex area of the law and no attempt will be made here to discuss it. It would be fallacious to regard these various exceptions where the Courts have been prepared to venture beyond Salomon as exclusive. Certainly the development of further exceptions is probable particularly in view of the pronouncements of the Court of Appeals in Wallersteiner v Moir.(391) Although we will be looking at this case in more detail elsewhere, it is pertinent to mention that Lord Denning M.R. was critical of the use of foreign companies incorporated in places not well known for the strictness of their incorporation laws, for trading in the British Isles. Referring to one of Dr.Wallersteiners company's 'Rothschilds Trust', the Master of the Rolls said 'it was an obscure concern of little worth registered in Leichtenstein. That is a tiny European State squeezed in somewhere between Switzerland and Austria with a population of 20,000 all told'.(392) The Court of Appeals distaste for the utilisation of Leichtenstein and Bahamas(393) in this manner was evident.(394) The Master of the Rolls considered 'that it is plain that Dr.Wallersteiner used many companies, trusts and other legal entities as if they belonged to him. He was in control of them as much as any 'one-man company' is under the control of the one man who owns all the shares and is the chairman and managing director'.(395) It is not without interest that

Mr Lincoln Q.C. for Dr Wallersteiner maintained that the principle in Salomon was sacrosant and that if the Court attempted to treat the various companies and concerns 'as being Dr Wallersteiner himself under another hat we should not be lifting a corner of the corporate veil. We should be sending it up in flames'.(396) On the other hand Mr Nicolas Browne-Wilkinson Q.C. as amicus curiae suggested that all the various overseas companies were in fact used by Dr.Wallersteiner as a facade 'so that each could be treated as his alter ego. Each was in reality Dr.Wallersteiner wearing another hat',(397) Lord Denning in a most significant statement observed that 'I am prepared to accept that the English concerns-those governed by English Law or its counterparts in Nassau or Nigeria - were distinct legal entities. I am not so sure about the Liechtenstein concerns...'(398) Although some have greeted this statement as a repudiation of the separate corporate entity principle in the case of such foreign companies, in view of the acceptance of the use and separate entity of Nassau incorporated companies it would seem that this is an over hasty interpretation of what the Master of the Rolls really meant. It would preferably appear that the Court only doubted whether Liechtenstein corporations should be recognised as having a separate corporate personality, because no evidence had been given to the Court on this point and the law in Leichtenstein. Thus the Master of the Rolls was not saying that the Courts would not recognise the separate legal entity of foreign corporations but that in cases where the company had not been incorporated in a jurisdiction operating a legal system based on the British law, affirmative evidence would have to be presented to the Court that the foreign jurisdiction concern did indeed itself recognise that the corporation had a separate legal personality. This is of course the usual practice in such cases. However, Lord Denning continues that despite the assumption that all the companies had a separate legal personality in theory they were in fact merely the puppets of Dr.Wallersteiner, 'he controlled their every movement each danced to his bidding. He pulled the strings. No one else got within reach of them. Transformed into legal

language they were his agents to do as he commended. He was the principal behind them'.(399) Thus Lord Denning held that the corporate veil should be lifted and that Dr.Wallersteiner should be regarded as responsible for the activities of his creatures.(400) Whilst the remainder of the Court,(401) was far more cautious and guarded in their observations than the Master of the Rolls it would appear that there was basic agreement on this point.

Whether the Courts would be prepared to lift the corporate veil in cases of insider trading is thus a matter of some uncertainty. There has been a growing trend to penetrate corporate personality where there has been 'fraud' and abuse of the type exhibited in the Wallersteiner case.(402) Furthermore the profits made by certain trusts and companies in the control of Sir Denys Lowson, which made profits by insider trading were treated as making the profit for Sir Denys, who was thus 'obligated' to make restoration by the Department of Trade Inspectors in their Report on the affair. The safest answer, although hardly helpful is that much would depend upon the individual facts and the degree of identification of benefits.

Given the rather confused state of the British law on this point, it might be of some assistance to briefly examine the law on lifting the corporate veil in some other countries. The American jurisprudence on the doctrine has been of major significance in influencing the practice of many other countries in Europe, and others such as the Philippines.(403) The basic approach of the American Courts is aptly summed up by Circuit Judge Sanborn in U.S. v Milwaukee Refrigerator Transit Company, (404)'...a corporation will be looked upon as a legal entity as a general rule...but when the notion of legal entity is used to defeat public convenience justify wrong, protect fraud, or defend crime the law will regard the corporation as an association of persons'.(405) Professor Cary puts the test slightly differently, 'whether individual controlling shareholders or a parent corporation are involved the same question arises, do the facts warrant the application of equitable principles

should the court go behind the corporate personality of one company in favour of the economic entity of which it is part'.[406] Throughout the American authorities there is the strain that the Courts will not allow the corporate fiction to be used to facilitate an abuse.[407] or to frustrate a legal remedy.[408] Thus it is accepted that there is no concept of corporate personality that will suffice to solve all situations, and that resort has inevitably to be had to the broad principles of equity.[409]

The mass of case law in the United States on the practical application of this broad principle is just too voluminous to be given attention here. However it would seem that the Courts are reluctant to allow actions against the shareholders of a corporation in disregard of the separate corporate personality of the company in the absence of agency or fraud.[410] Where separate corporate personalities are used with the objective of evasion of the law, or policy of legislation the Courts will lift the corporate veil. This much was laid down by Chief Justice Cardozo, who held that,

> 'it has often been held that the interposition of a corporation will not be allowed to defeat a legislative policy whether that was the aim or only the result of the arrangement...the courts will not permit themselves to be blinded or deceived by mere forms of law but will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require'. (411)

In another case it was stated, by the Supreme Court of Connecticut that 'where a corporation is manipulated by an individual or another corporate entity as to become a mere puppet or tool for the manipulator justice may require that the courts disregard the corporate fiction and impose liability on the real actor'.[412] It would thus seem that wherever necessary to prevent evasion of the anti-insider trading laws in the United States, the Courts would generally be prepared to penetrate the principle of corporate personality.[413]

The bulk of continental law on lifting the corporate veil has been absorbed from the United States of America, although there is little doubt that the principle has become established in the corporation laws of most

European states, at least to some extent.(414) Apart from in the field of taxation there are few statutory provisions, and there has been no codification of the law on this matter. It would also appear that in all countries in Europe, lifting the corporate veil is treated as an exception to the corporate personality rule, which as a norm is paramount.

Whilst it has been contended in West Germany that the principle of corporate personality is so fundamentally important it should remain inviolate except where there is intentional abuse and fraud the Courts have rejected this approach as too restrictive.(415) It has been accepted that the separate personality of the corporation and its sole participator, cannot always be separated, and 'if the realities of life, the economic requirements and the power of facts render it imperitive for a judge to disregard the differentiation of the personality and the assets of the corporation and its sole participant'.(416) Thus to penetrate the veil of incorporation, the German Courts do not require a fraudulent intention or purpose. There are a number of cases where a sole or controlling shareholder has been held liable for the companies debts.(417) It would also appear that where a sole of controlling shareholder utilises the company for 'obtaining immoral profits' such as a bribe, he himself will be liable to repay such even if it was paid to the corporation.(418) This would seem to have obvious implication for insider trading profits.

There are provisions in the Aktiengestz 1965 which in effect penetrate the corporate veil, and of particular significance in this respect are the provisions relating to groups of companies and holding and subsidiary companies. Another provision of some interest in this respect is Article 117 which deals with abusive influence on companies.(419) Apart from this with regard to statutory provisions it is to be doubted how effective the German cases illustrating the lifting of the corporate veil are. There are certainly very few instances where the veil has been successfully lifted and most could have been decided on some other ground.(420)

Due to the greater variety of corporate forms in France

than exist in Britain, the United States or Germany the law on lifting the corporate veil is significantly more complex. There are a number of provisions in the various statutes dealing with the business organisations constituted thereunder which pierce the corporate veil.(421) Of some interest is a Decree of the 20th March 1955 under which the bankruptcy of a company may be extended to all those persons who have carried out their own commercial transactions under the cover of the company and have used the company's assets as though they were their own, alternatively under a Decree of the 9th August 1953 in determining a case of a company's bankruptcy the court can hold all or part of the company's liabilities to be placed on those who have taken an active part in the company's management.(422) There are a number of cases where the Courts have made orders under these provisions.(423) There are also cases adopting the notion that a company created in order to conceal the personal transactions and activities of a person is a fictitious entity which need not be regarded as a separate personality from that particular person.(424) The law in France and Germany, like continental civil law generally does not recognise that the place of incorporation is determinative in issues concerning conflict of laws, but where the real seat of business is, and thus the problem of piercing the veil of foreign corporations does not present the same problems as in the United Kingdom.

The law in Italy, whilst rich in academic writings is confused by the presence of companies with varying degrees of juristic personality.(425) Among the various theories in Italian jurisprudence concerning corporate personality there is that of the 'imprenditore occulte' which provides that a controller who hides behind a company which he uses 'as an instrument of his will' will be identified with the corporate personality. The personality of the corporation can also be merged with that of a sole shareholder in the case of the company's bankruptcy under Article 2362 of the Civil Code.(426) The Italian Courts, particularly the superior courts have not shown a great willingness to espouse the notion of 'imprenditore occulte' however, and have basically

fastened on the more formalistic approaches to corporate personality.[427] Whilst there are a number of statutory provisions which result in lifting the corporate veil,[428] and a number of lower court decisions, the superior courts treat the doctrine as having minimal impact on corporate personality.

The Swiss Federal and Cantonial Courts have been influenced to a great extent by the German law,* and thus generally assume a complete separation of personality between a corporation and its shareholders.[429] However the Courts have accepted that there must be exceptions, and have applied the goodfaith and abuse of right tests utilised in Germany.[430] The approach of the Swiss Courts has been cautious and hesitant, and as a general proposition the Courts will not allow the corporate veil to be lifted where such would benefit the controller,[431] although this is not always the case.[432]

There are cases where the Federal Supreme Court, in particular has gone to considerable lengths in penetrating the veil of corporate personality, and held the corporation liable for the fraud of its sole director, and probably sole shareholder. In Regana v Saxer,[433] the Supreme Court emphasised that the crucial factor was the identity of economic interest between the corporation and the perpetrator of the fraud. The Court pointed out that even if the members of the wrong doers family had also been shareholders there would still have been a sufficient identity of economic interest.[434] In Leuziger v Staatsanwalt Thurganu,[435] a controller was held liable for the criminal acts of the sole director of the company who had undertaken to abide by the controllers orders. The Federal Supreme Court emphasised that originators of crimes should not be allowed to hide behind the administrative organs of companies under their control. Although nominees are extremely difficult to go behind in a domestic environment they have proved almost impenetrable on the international level.[436] There are procedures for requiring disclosure of ownership, and investigating such in the Companies Acts, and under various other statutory provisions, however such are in most instances jurisdictionarily, and in all cases practically confined

to matters arising within the United Kingdom. Where foreign nominees are involved the problem is significantly greater. It might thus be instructive to examine the experience of the United States of America in this field, both with regard to domestic and foreign nominees.

(h) NOMINEE REGISTRATION IN THE UNITED STATES OF AMERICA

Let it be said at the outset that 'one of the problems that the SEC has not yet resolved involves the regulation of securities in the names of nominees, brokers, banks and trust companies'.(437) A very common method of holding securities in the United States is in 'street name', 'these are securities held in the name of a broker instead of his customers name... this occurs most often when the securities have been purchased on margin, or where the customer wishes the securities to be so held...'(438) Street names are used on a great many stock certificates, as this saves the investor considerable trouble in handling the certificates, and facilitates transfer.(439)

There have been a number of surveys and analyses of share-ownership and holding in the United States, and although there are differences in the results of such it would seem that something between 23% to 30% of securities in the United States, of public companies, are held either in street name or by a nominee.(440) To this figure must be added the vast amount of capital in the hands of institutional investors. The New York Stock Exchanges Fact Book for 1974, stated that the institutions held over 45% of the securities traded on the Exchange.(441) In recent years the American Government has become increasingly concerned about the level of institutional control and the presence of large foreign nominee holdings.(442) As a result of recent Congressional activity in this field it is likely in the near future that the disclosure obligations, relating particularly to the institutional investors and, large nominee and trust companies, with regard to equity ownership will be increased.(443)

The nominee problem has confronted the SEC in two areas, in particular, they are the regulation of proxies and the detection of fraud, including insider trading. It is upon the second aspect, that attention will here be given.(444) On 12th August 1957, Senator J.W.Fulbright, the Chairman of the Senate Committee on Banking and Currency wrote to the Chairman of the SEC, Mr. E.N. Gadsby emphasising that the Committee was 'concerned about the possible evasion of the Federal Securities Laws...accomplished by trading in United States corporate securities through foreign

institutions that as a matter of law and practice decline to disclose the identity of their clients. 'The letter, also expressed the concern felt by the Congress and a number of other Federal agencies, and asked the Commission to institute a study of the matter.(445) The Staff of the SEC immediately started to make a comprehensive study of the question of evasion through foreign institutions and nominees. The Staff Report,(446) found that foreign institutions and corporations had been used in a number of occasions as a means of concealing the identity of the persons involved and the nature of the transaction,(447) this was particularly so with regard to the anti-fraud provisions of the securities laws. The Staff also stated that even where foreign individuals had been used it was just as difficult to discover the true fact unless that person was willing to cooperate fully and freely with the SEC. Otherwise the Commission could do nothing. The Staff emphasised that 'a principle effect of the use of these foreign devices is to delay or impede the Commissions investigations because of the absence of subpoena power to compel the production of evidence from a foreign jurisdiction'.(448) The Report stated that it was often possible and indeed relatively easy by pursuing all available lines of enquiry within the United States and by seeking the cooperation of Foreign administrators to establish that a violation had in fact occurred. However it was not always possible to obtain evidence or jurisdiction over the persons involved. The Staff pointed out that the alternatives 'involved the laborious and expensive process of tracing securities and funds, and locating and interviewing numerous witnesses, no one of whom was fully aware of all the pertinent facts'.(449)

The Staff Report stated that in most cases it was probable that the fraud or scheme either originated in the United States or was participated in by persons within jurisdiction, and thus there was always the possibility that action could be taken in the United States, on the basis of circumstantial evidence. It was also observed that this possibility had acted as a curb on the activities of some persons resident within jurisdiction. Where corporations are involved, under Section 19(a)(2) of the

Securities Exchange Act 1934, the SEC after appropriate notice and opportunity for hearing, may by order suspend for a period or withdraw the registration of a security traded on a national securities exchange if it considers that the company has failed to comply with the Act and rules made thereunder. The Commission has used this section against foreign issuers, and in particular Canadian companies.(450)

By making copious studies of the type of operations that are staged from abroad the SEC has sought to perfect techniques and procedures that have as their objective the obtaining of the maximum amount of evidence within 'suppoena jurisdiction'. The Commission has benefited from an 'informal' arrangement to pool information among the various arms of Government, and thus in any given instance the State Department, Federal Reserve Board, and other Banking Agencies, The Treasury, Post Office, Departments of Commerce and Defence, and the Inland Revenue as well as such organisations as the Federal Bureau of Investigation, and Interstate Commerce Commission, can be called upon to assist in obtaining evidence. There is also an ever increasing degree of International cooperation,(451) which the SEC considers both important and beneficial.(452) However, the Chief Regional Administrator, for New York, which of course deals with by far the biggest proportion of domestic and international securities business,(453) considers that nominees are still a major problem in the effective enforcement of the present laws.(454) However, The Regional Administrator and his Assistant,(455) informed the present author that the nominee problem only becomes serious once the investigation has been started; there is generally no problem at the outset as unless there is knowledge of the identities of at least some of the participants or reasonable suspicions the enquiries would never be commenced.(456) The Regional Administrator and his officers, thought that, the primary sources of trouble, at least from their point of view were the Swiss Banks, and a number of developing financial centres in the Far East. The view from the SEC in Washington was slightly more pessimistic however. The Head of the Office of Market Surveillence, directly concerned with

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the detection, and enforcement of the anti-insider-trading laws,(457) stated to the present author that 'nominees and foreign institutions acting as nominees are a serious and insoluable problem'.(458) The same problem, as that pointed out in New York, was voiced in Washington, that is that with nominees abuses and improprieties are generally not detected in the first place and thus an investigation is never even considered. Certainly the Commission did not have the resources to go 'nominee spotting' in the absence of any suspicions.(459)

It is not without interest that at least two senior attorneys in the Division of Enforcement, stated that because of the 'political sensitivity of foreign nominees' the Commission had in the past had to behave unduly diplomatically. It was the very countries which afforded the greatest opportunities for nominees and their principals, that the State Department was particularly cautious about upsetting. It would seem that the most viable solution would be through strengthening international cooperation and the fostering of treaties directed to mutual assistance in such cases.

The then Chairman of the SEC, the Hon.Ray Garrett, at the London Conference on Insider Trading, in the Spring of 1975, stated that nominee registration had ceased to be a problem in the United States, and in the context of foreign nominees was rapidly being resolved by cooperation. Professor Loss broadly agreed with this.(460) This would not seem to be the view however, of the staff of the SEC, both at its Head Office and at the main Regional Office.

The Staff Report, of 1958, concluded that although the existence of violations of any laws administered by the Commission was a source of serious concern, when the number of possible villations involving foreign nominees and banks were compared with the total volume of securities transactions the figure was minute.(461) The Staff stated that 'because of the relatively minor impact of the problem upon the capital and trading markets' of the United States, 'we believe that any legislative proposals designed to prevent such violations which would seriously burden the securities industry ...or materially interfere with the international flow of securities in and out of the

United States do not appear to be warranted at this time'.(462) As with other questions that involved jurisdiction the Staff Report emphasised that 'The basic difficulty inherent in national sovereignty cannot be solved by domestic legislation short of legislation which would materially and adversely affect international commercial intercourse'.(463) Given the political and diplomatic considerations, the Staff thus recommended no legislation and this was endorsed by the Commission itself.

Although the Staff Report did not consider domestic legislation either desirable or feasible, it did make suggestions as to how the problems could be practically reduced, and these are still accepted as valid today by the Commission.(464) The Staff Report pointed out that as far as persons within jurisdiction were concerned, the matter was purely one of domestic enforcement and thus improvements in this would inevitably assist in foreign transaction cases. In this respect the availability of injunctions against persons, particularly professionals in the securities industry, and disciplinary procedures could be used with great effect. The Staff further thought that an obligation should be placed on brokers and dealers to report immediately to the SEC any substantial order from abroad. This would not of course catch transactions placed through American based nominees, but this was thought not over serious as there would then be participants thus within jurisdiction.(465) The Staff considered, but rejected on the grounds of being too burdensome, a suggestion that before accepting a foreign order, a broker or dealers should secure from the client an agreement to consent to service and to cooperate fully with the SEC. It was also thought that this would be politically objectionable.(466) Perhaps the most significant recommendation was that the United States authorities should assist in the development of international cooperation, particularly with regard to the exchange of information, and that meaningful mutual assistance treaties should be entered into to assist in enforcement.(467)

The Staff Report emphasised that it would be

desirable to enter into such a treaty with Switzerland as soon as possible, this was not then feasible however.[468] After some considerable negotiations and the carrot of supplying American war planes and entering into a favourable dairy produce agreement, the Swiss Government signed a treaty of mutual assistance on legal affairs with the United States in 1973, which was not however ratified until June 1975. Under this Treaty the Swiss Government has introduced amending legislation to allow, on request of the United States Authorities information to be given in the prosecution of criminal cases and in instances of tax evasion. There is still considerable doubt as to exactly what the treaty will allow, and the Guardian Newspaper stated 'it is unlikely that the treaty will enable the American Authorities to clean up all the wheeling and dealing conducted by their citizens within Switzerland'.[469] The Staff of the SEC would also seem to be sceptical about how far this treaty will practically assist them,[470] although the Chairman was most enthusiastic about this development at the London Conference on Insider Trading in 1975. There have of course been similar treaties with other countries, such as Canada and the Philippines which have worked reasonably well. There has been criticism of the techniques employed, by the American Tax Authorities, in particular, such as the infiltration of undercover agents and the retention of local informants in other countries, mostly in the Carribean, and it seems likely that a similar approach, to that adopted with Switzerland will be adopted with other countries, and the matter be placed on the 'cleaner' basis of bilateral treaties.[471]

Given the significance of the nominee facilities provided in particular by Switzerland, it might be advantageous to briefly examine the relevant Swiss law and procedure on this matter, paying particular attention to the provision of information to external regulatory agencies such as the American SEC or Metropolitan and City of London Company Fraud Department.

(I) BANKING SECRECY LAWS IN SWITZERLAND

The importance today of Switzerland as a major international financial centre needs no emphasis here. Apart from the country's political stability and geographical accessibility, it has attracted a significant proportion of its clientel because its banking institutions observe, under law, a well nigh impregnable shield of secrecy and confidence. In recent years there has been considerable controversy between the Swiss and the United States Government and to a lesser extent the EEC, concerning the formers lack of cooperation in tracking down tax evaders and those allegedly using the Swiss banking facilities for improper purposes. Whilst there can be little doubt that the Swiss facilities are used for nefarious purposes in certain instances,(472) much of the controversy 'stems from distorted accusations, compounded by misconceptions of professional standards widely observed in Europe'.(473)

Whilst the Swiss banks maintained a degree of secrecy common among financially developed countries, this was placed on a statutory basis in 1934, ostensibly to protect clients of the institutions from the German Gestapo. The bankers duty of secrecy in Switzerland has many similarities with that operated in other countries, including the United Kingdom,(474) and is by no means an unusual feature of the duty of secrecy that a bank in Switzerland, or indeed anywhere else, will generally refuse information about its customers to foreign or for that matter domestic regulatory agencies, in the absence of a specific statutory duty so to do. However as Professor Hans-Peter Friedrich, has pointed out,(475) the duty as conceived and operated in Switzerland is particularly strict and has certain additional aspects. In Switzerland there are no statutory provisions generally allowing the Federal and Cantonial authorities, such as in the case of tax evasion to demand information.(476) Naturally there is no obligation to supply foreign agencies, particularly tax authorities with such information.(477) Whilst Swiss law does not admit of general exceptions to secrecy, there are nonetheless a

number of public policy exceptions where it has been breached. For example the criminal procedure codes of most Cantons require the production of records and evidence in the case of criminal prosecutions.(478) Thus disclosure of banking information is required in the case of criminal prosecutions and also in such matters as inheritance, bankruptcy and debt collection.(479)

Thus the Swiss banks will generally only have to provide information when the allegations amount to a crime, recognised by Swiss law.(480) As Professor Hirsh, of the University of Geneva pointed out at the London Conference on Insider Trading, this is the problem with tax evasion and insider trading, as neither of these 'abuses' are regarded as criminal matters.(481) Furthermore the Swiss Courts and judicial authorities will closely analyse allegations from both domestic and foreign authorities to ensure that such amounts to a recognised crime at Swiss law.(482)

The common law position has been statutorily reinforced, by Article 47 of the Swiss Banking Law of November 8th 1934, as revised on March 11th 1971. Professor Friedrich states in an article of this area of the law,(483) that it was thought that customers should be afforded penal as well as civil remedies in the event of a wrongful disclosure of information, by a Swiss bank. In Professor Friedrich's view monetary compensation might not be sufficient 'where for instance the banks action had resulted in the taking of criminal proceedings against him'. Article 47,(484) as revised provides that,

> Whoever divulges a secret entrusted to him in his capacity as officer, employee, mandatory, liquidator or commissioner of a bank, as a representative of the Banking Commission, officer, employee of a recognised auditing company, or who has become aware of such a secret in this capacity and whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed six months or by a fine not exceeding 50,000 francs'. (485)

It is however stated that 'if the act has been committed by negligence the penalty shall be a fine not exceeding

30,000 francs'. It should be noted that this is a crime of strict liability.(486) Furthermore the violation of professional secrecy remains punishable under Article 47 ever after termination of the official employment relationship or the exercise of the profession. It is however provided that Federal and Cantonial regulations concerning the obligation to testify and provide evidence to the Government authorities remains.

The Swiss Criminal Code in article 273 also contains provisions of some interest to this present discussion. This article primarily concerns 'wirtschaftlicher Nachrichtendienst or industrial and economic espionage but does have a wider significance. It provides that,

> 'A person who, through searching, secures a manufacturing or business secret in order to make it accessible to a foreign agency or to a foreign organisation or to a private business enterprise or to their agents, a person who makes accessible a manufacturing or business secret to a foreign official agency or to a foreign organisation or to a private business enterprise or to their agents shall be punished by imprisonment'.

Bank secrets apparently are included in the term 'trade or business secrets'. In a memorandum to the Senate Sub-Committee in the Amendments to the Securities Acts in 1959, The Office of the General Counsel to the SEC stated that 'it is clear that Article 273... could operate to prevent not only the bank's releasing information about transactions but also any spying by a third person to obtain the information'.(487) Professor Friedrich, in his article,(488) cites cases where employees of Swiss banks have been convicted and sentenced for violations of this particular article. The problems presented by the provision of information within the scope of Article 273 to foreign regulatory agencies, has recently been shown in the prosecution of Mr.Stanley Adams by the Basle authorities. It appeared that Mr Adams, who had been an officer of F.Hoffmann La Roche et Cie, A.G. had passed on certain information to the E.E.C. 'Commissions Anti-Trust Office, about the prices of vitamins produced by his employer, and which were directly relevant to the EEC competition and fair trading rules. The company in conjunction with the Basle Canonial prosecutor instigated criminal

proceedings against Mr. Adams and he was remanded in custody, for inter alia violating Article 273. The Swiss Government under Treaty with the EEC had agreed to observe the EEC's competition and fair trading policies, and the EEC Commission thus immediately sprung to the defence of Mr. Adams who incidently had derived no monetary gain through the episode, and had informed the Commission solely out of a feeling of public duty. After a considerable amount of diplomatic activity, Mr. Adams was released on bail, put up by the EEC Commission. In August 1976 the Basle Cantonial Criminal Court convicted Mr. Adams, in his absence, and sentenced him to a twelve months prison sentence, which was however suspended. He was also ordered to pay £1,000 costs and banned from the Federation.(489) It emerged from this case that the officers of the E.E.C.'s Anti-Trust Office had not entered Switzerland for sometime for fear of being arrested themselves as accomplices to the violation of Article 273. Obviously this is all highly unsatisfactory and does not augur well for cooperation in the field of securities regulation.

There are also other provisions in the Criminal Code that are applicable to this area of the law,(490) but of particular significance are Articles 41 and 49 of the Code of Obligations which provide for civil recovery where property is wrongfully used, and a bank secret, in Swiss law is considered as intangible property such as would be comprehended by these articles. The Swiss authorities have in recent months been far more active in the enforcement of the banking and currency laws, than has been the case in the past,(491) and it would be fallacious to consider these provisions in any way academic, as the prosecution of Mr. Adams has proved. The Swiss banks are generally meticulous in the observance of these laws and the obligations of secrecy, and the Government has not been over-concerned about interfering with such, given the undoubted revenue that the promise of silence attracts.(492) The Banks and the Swiss authorities have in a number of instances flatly refused assistance and information, even when litigation has actually been started,(493) and acquired a reputation for seeking to protect their clients confidentiality to an extent that is openly aggressive.

Of course the client can always waive the duty of secrecy, but naturally it is often the client concerned who most wants to preserve it. Furthermore the duty of secrecy extends to all information about customers, and not merely to identity.

In addition to the legal protection that is afforded, the Swiss banks have devised an elaborate set of procedures. to ensure the depositor that his identity and account details remain confidential and secret. This additional safeguard involves the use of 'pseudonym or numbered accounts'. Instead of the client being identified by name, the client and his account are identified for all purposes by false or assumed names or a set of numbers.(494) As it is impossible to open an account with a Swiss bank unless the identity of the account holder is disclosed to the bank, these accounts are not anonymous. As Professor Friedrich points out it would be perfectly possible under Swiss law for an account to be opened by an agent for an undisclosed principal, and thus the true identity of the client would remain concealed from the bank.(495) The Swiss banks as a matter of practice generally require a declaration that the person disclosed as the account holder is beneficially entitled to the money and property therein, and indeed the Swiss law is not too helpful to beneficial owners without legal title. Thus Professor Friedrich stated that 'although it is theoretically possible for banks to accept assets from unknown persons, it must be said that Swiss banks are not readily prepared to do so, indeed Swiss banks will never really accept large sums on these terms'.(496) The Swiss banks in their booklet on Swiss banking secrecy, entitled 'the truth about Swiss Banking' state that 'when a numbered account is obtained under false pretences a responsible bank peremptorily closes it and tells the owner to take his business elsewhere, preferably out of the country'. The Swiss banks have of course their own reputations to consider, and by according the facilities of a numbered account obviously forego considerable protections, their general management services lose the ability to refer to the client and seek instruction.(497)

The Swiss banks have been increasingly criticised in recent years and have sought to justify their positions and ethics. In a letter circulated by the Swiss Bankers Association in 1957,[498] it was emphasised that member banks should not engage in activities in the USA on behalf of their clients which would be violative of American laws. Similarly in 'the Truth about Swiss banking' it is stated that the Swiss banks have 'too much at stake to wink at unethical professional conduct or engage in practices that are not compatible with the laws of their own or other countries'.[499] Furthermore the Swiss have pointed out that only a relatively small proportion of accounts are numbered, and moreover a very high proportion of the accounts in Swiss banks belong to residents of the country in any case. Of course there are a number of banks and institutions that are outside the more respected groupings of banks, and the Swiss Bankers Association, has publicly requested its members to apply pressure on the smaller banks and houses to conform to the 'proper approach' to securities transactions involving foreign countries.[500]

There has been increasing pressure on the Swiss to reconsider their position however. The mutual assistance treaty with the United States, has already been mentioned, and it is known that the EEC Commission would like to come to a similar agreement,[501] as would many European countries individually. It was even suggested that the Swiss banks should relinquish their numbered accounts and ultra secrecy before their currency should be admitted to the European' 'snake'. The Bankers Association, issued a statement in defence of the present system, and it would seem that no immediate change is likely.[502]

Of course for a British subject to legitimately open a Swiss bank account, it is necessary for him to obtain Exchange Control permission, from the Foreign Assets Office of the Bank of England, generally on application through his own domestic bank. This Office will only give permission where it is for legitimate commercial reasons, and then reluctantly. However it is generally accepted that these regulations would not stop anyone

who was particularly determined to obtain the facility of of a Swiss bank.

Finally, before leaving this part of the discussion, it is interesting to refer to the method of obtaining disclosure of nominees and banks which has been used in the United States on several occasions and in Canada. This is essentially effected by applying pressure upon the banks branch office or property within jurisdiction, or by threatening cancellation of the banks right to continue trading in that country. In the most recent case, in the United States, involving the Swiss Credit Bank of Zurich, a Federal District Court ordered the bank to transfer $ 150,000,000 and $ 200,000,000 to its American branch, or else the Court would cease all its assets in the United States.(503) The Federal Court also demanded, and in effect obtained, information concerning certain transactions carried out by the bank.(504)

It would be misconceived to think that Switzerland is the only country with laws protecting banking secrecy and restricting the disclosure of information about principals trading through financial institutions. There are a number of other countries which have similar, and in a few cases more far reaching provisions.(505) There have been cases where it has been discovered that banks, protected from disclosure, in one country have acted as agents for banks similarly protected in another country, who are in turn acting for an undisclosed principle. In such cases the problems are insurmountable, and indeed detection in the first instance would only be by chance. Obviously the key to these problems is international cooperation, but given the fact that for any real improvement there would have to be virtually worldwide agreement, it is likely in practical terms the problem of offshore nominees and the foreign nominee will not in the foreseeable future be solved.

(C) DISCLOSURE OF INSIDER'S INTERESTS

(I) COMMON LAW DUTIES OF DISCLOSURE

Although insider's self-dealing is vitally connected to the problem of insider trading, given the confines of space it is only possible to give passing reference here to the relevant law.(506) Promoters, perhaps the arch-insiders, are clearly in a fiduciary relationship with the company, which obligates them to observe a strict duty of disclosure 'as to every thing that it is proper for the directors to know in order that they may form a fair judgment of everything material to any transaction' involving him.(507) The fundamental principle that equity will not allow a fiduciary to place himself in a position where his interest conflicts with his duty(508) applies to company directors and other corporate fiduciaries. It has been held that the 'trustee-like position of a director' vitiates any contract which the board of directors entered into, on the company's behalf with one of their number.(509 In Aberdeen Railway Company v Blaikie (510) Lord Cranworth L.C applied this principle and held that to validate the transaction it was necessary to obtain the authority or ratification of the general meeting after full disclosure. Otherwise the transaction was voidable at the company's option.(511) The structures of the common law were also reinforced by disqualification provions in articles of association of many companies.(512)

The common law position has, however, been substantially modified by legislation.(513) Under section 199 it is the duty of a director of a company 'who is in any way interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors'. In the case of a proposed contract the declaration is to be made by the interested director at the meeting of the board at which the question of entering into the contract is first taken into consideration, or if the director was not at the date of the meeting so interested at the very next meeting of the directors after he becomes interested in the transaction. It is provided that for the purpose of section 199 a general notice 'to

the effect that he is a member of a specified company or firm and is to be regarded as interested in any contract which may after the date of the notice be made with the company or firm', shall be deemed to be a sufficient notice. However, it is provided that 'no such notice shall be of effect unless either it is given at a meeting of the directors or the director takes reasonable steps to secure that it is brought up and read at the next meeting of the directors after it is given'.(514) Any director who fails to comply with this duty of disclosure is liable on conviction to a fine of £100. This is of course a grossly inadequate sanction as was shown in the Lowson affair, where repeated violations of Section 199 were discovered by the Department of Trade Inspectors, the result of which enabled Sir Denys Lowson to net a profit of some £5,000,000 by inter-company transactions in which he was personally interested.(515)

It is, however, provided in Section 199(5) that nothing in section 199 is to be taken as prejudicing the operation of any rule of law restricting directors of a company from having any interests in contracts with the company. Thus the effect of this provision is to limit the scope of exemptive provisions, that were common in the past, in articles of association. Furthermore in addition to the rather derisory criminal penalty failure to comply with Section 199 will automatically remove any protection otherwise provided by exclusion provisions in the articles, and bring the basic equitable rule of avoidance in the absence of full disclosure and ratification into effect. It should be noted that compliance with Section 199 does not of itself have a validifying effect on the contract, it is purely negative aimed at limiting the effect of exclusion clauses.(516) It should also be noted that disclosure under Section 199 is to the board of directors, and not to the general meeting. Moreover, from the wording of Section 199(2) it would appear that only those contracts considered by the board of directors need be disclosed, and it is not without interest that the Institute of Directors in their memorandum of evidence to the Jenkins Committee stated that contracts were very rarely considered by the board.(517)

The term 'interested' is not defined, and although there have been a number of decisions examining similar provisions in articles of association none are particularly authorative so far as Section 199 is concerned. In the case of disqualification provisions the Courts interpreted the word very narrowly[518] whereas under the general law an 'interest' arising by merely holding securities as a trustee has been sufficient to require disclosure.[519] An agreement with the company for the allotment of shares would seem to be a sufficient interest,[520] as would the issue of debentures.[521] It would seem preferable as a matter of policy that the term should be construed widely.[522]

Under Section 199 the 'nature' of the interest must be shown and this would invariably mean that the extent of the interest must be disclosed. As has already been indicated under the general law some quantification of the expected benefits would have to be disclosed, although as Lord Radcliffe has emphasised 'the amount of detail must depend upon the nature of the contract or arrangement proposed and the context in which it arises'.[523] Lord Radcliffe continued that 'if it is material to their judgement that they should know not merely that he has an interest but what it is and how far it goes, then he must see to it that they are informed'.[524] Whilst the disclosure as to the nature of the interest must thus be full and frank, this is qualified by the facility of a general notice. The Inspectors in the Lowson affair, emphasised on a number of occasions,[525] that in the circumstances of that case where interlocking directorships a general notice was insufficient where it related to a personal interest in any transaction, as it would appear to the board that it was the fact of the common directorship that was being disclosed. The Inspectors also pointed out in the type of transactions involved in that case only 'a full and specific declaration' with a reasonable amount of other relevant information would have enabled the other directors to form a proper view of Sir Deny Lowson's personal involvement. This affair certainly underlined the importance of Section 199 in the regulation of insider trading, as if it had been complied with, the

manipulations of Sir Denys and his associates, which facilitated his insider trading would have been detected and hopefully obviated.

Apart from Section 199, Section 16 of the 1967 Companies Act,[526] lays a number of 'additional matters of a general nature' as oposed to the specific requirements of sections 17 to 20 regarding the affairs of the company on which information is required to be given by the directors to the shareholders in the annual report. Section 16(1)(c) requires stipulated details to be given of the parties, nature and extent of 'any contract with the company in which a director ...has or...had at any time in the last financial year...directly or indirectly, an interest, being in either case, in the opinion of the directors, a contract of significance in relation to the companies business and in which the directors interest was substantial or material'.[527] The Act does not however, define or indicate what contracts are of significance and leaving such a crucial determination in the hands of the directors inevitably reduces the impact of Section 16, as a disclosure mechanism.[528] The editor of Gore Browne points out that the limitation of the disclosure obligation to material interests is narrower than the duty imposed under Section 199,[529] The Council of the Stock Exchange in Notice Number 84/71 has sought to clarify this area for listed companies.[530] Section 9 of the Listing Agreement requires listed companies to circulate with the annual directors report certain information, inter alia paragraph (h) states that 'particulars of any contract subsisting during or at the end of the financial year in which a director of the company is or was materially interested and which is or was significant in relation to the company's business', must be given. The Council of the Stock Exchange in their notes, state that they have considered it desirable to 'establish stricter criteria for determining what contracts should be disclosed', and thus all companies whether incorporated in the United Kingdom or not, 'are accordingly required to disclose in addition to any contracts so required by law any contracts or arrangements,[531] which would be required to be

disclosed if section 16(1)(c) were applicable 'with the Stock Exchanges interpretations'. The Interpretive notes state that a contract shall be deemed to include an arrangement and a contract with a subsidiary of the company shall be taken into account as if it constituted a contract with the company.[532] Moreover a contract of significance' shall be deemed to include any contract or number of contracts, whether related or not and whether or not the parties thereto are the same in each case, in which the directors interest is or was material and which in aggregate represents in amount or value a sum equal to more than 1% of the company's total, purchases, sales, payments or receipts as the case may be, or in the case of a capital transactions including those a principle purpose of which is the granting of credit, more than 1% of the net assets of the company. Where the company has subsidiaries comparison may be made with the purchases, sales, payments, receipts or net assets of the group on a consolidated basis!. The term 'interest' is under the Councils notes to be interpreted mutatis mutadis as in sections 28 and 31 of the 1967 Companies Act. Thus it will extend to the interests of a directors spouse and infant children.[533] Thus for listed companies there is an amalgam of both statutory and contractual disclosure obligations in this respect. It is open to question as to how far the Courts would accept the Stock Exchanges interpretation in construing Section 16, although it would seem likely that the Courts would at least take such into consideration.[534]

The Listing Agreement makes it clear that in cases of doubt reference should be made to the Quotations Department, and it is expressly stated that some modifications may be required with regard to foreign companies. It is also provided that in complying with the requirements of both the section and the listing agreement the 'particulars given...must be sufficient to constitute a fair disclosure of the nature and extent of the contracts and arrangements but subject thereto and the provisions of the Act contracts and arrangements need not be dealt with individually if they are substantial in number. 'Whilst

the interpretive provisions of the Council are to be welcomed they only emphasise the dificiences of the drafting and limited conception of the 1967 Companies Act. They can hardly be an effective substitute for properly drawn up laws.(535)

Under Section 16(1)(d) where the company is or has been a party to an arrangement whereby directors are or were to be enabled to acquire benefits through the acquisition of shares in or debentures of the company or any other corporation specified details must be included in the directors report. Furthermore, section 23 casts a duty upon directors, reinforced by criminal penalties, to take reasonable steps to ensure that the required information is included in the report. Whilst the information in the report is given expost factoit is most important in that the particulars are actually sent to shareholders, and not merely available for inspection. It is arguable that an insertion in the directors report of material interest would in itself be a sufficient disclosure for the purposes of the general rule.

Provided that the statutory obligations are observed there is nothing to prevent the inclusion of specific provisions in the articles of association, limiting the directors duties of disclosure, or indeed for that matter increasing such. In practice such provisions in articles vary enormously. 'At their narrowest they provide that the interested director shall disclose his interest to the board, shall not be counted...in quoram and shall not vote'.(536) 'At their widest they enable an interested director to attend and vote just as if he was not interested'.(537) It is invariably provided that if the articles are complied with, the transaction will be fully binding upon the company and the director safe from the secret profits rule.(538)

Although there are of course a number of other provisions in the Companies Acts directed at self-dealing,(539) it is of interest that the White Paper on Company Law Reform(540) considered that there were areas where the combination of a fiduciary duty, and the duty to disclose were insufficient protections from abuse.(541) In the White

Paper, the Government stated that it was its intention 'if possible to legislate in respect of situations where directors seek to syphon off profitable business to their private advantage'. To this effect, Clause 45, of the Companies Bill 1973, provided that no person shall act as a director of a company which controls another company, if he or another member of his family is interested in the equity shares of that other company or a subsidiary of that other company. A person violating this provision would have been liable to a sentence of two years imprisonment or an unspecified fine, or both. Although it was provided that a person would not be guilty of such an offence if he could establish that he did not know at the time that he or a member of his family was interested in shares in the manner referred to or that he had become aware of the fact not more than fourteen days before that point in time.(542) The provisions in Section 28 of the 1967 Companies Act would have applied in the interpretation of this Clause, although control would have been separately defined in Clause 45(5) as existing where the other company or its directors were accustomed to act in accordance with the directions or instructions of the other company or that the other company is entitled to exercise control over one third of the voting capital of that particular company. Whilst there was a considerable amount of criticism directed at this provision,(543) the Secretary of State for Trade and Industry emphasised that the evil to which Clause 45 was sufficiently serious so as to justify the 'draconian' approach in the Clause, and it was not feasible to allow exceptions because it was not possible to separate the objectionable from the unobjectionable.(544)

The same philosophy is also present in Clause 46 of the 1973 Companies Bill, which provided that it would be unlawful for a company to make a loan to another company or guarantee or secure the loan by someone else if a director or directors of the first mentioned company are interested in equity shares of the other company to the extent of one third of its total equity share capital. Furthermore, it is also stated that it would be unlawful for a company to make a loan to a person who is a member

of the family of any of its directors, or of a director of its holding company or to guarantee or secure such.[545] This provision would have extended the present provisions in Section 190, which presently only forbids loans to directors.

The amendments to Section 199 suggested by the Jenkins Committee would in large measure, have been effected by Clause 47. The duty upon directors to declare their interests would have been extended to transactions involving the company but not necessarily coming before the board of directors. It is interesting in this respect that the Bill did not adopt the recommendation that there should be a defence where the director had no knowledge and could not reasonably have been expected to have had such.[546] This is all the more significant as the duty to declare the interest is not confined, again as the Jenkins Committee suggested to material interests.[547] Obviously the Clause in the form that it was presented would have been oppresively burdensome and unworkable,[548] and the provisions on general notice hardly came up to what the Jenkins Committee had recommended.[549]

The Companies Bill in Clauses 48 and 49 dealt with directors interests in management contracts and agencies, and generally followed the recommendations of the Jenkins Committee in this respect,[550] which had already been reflected to some degree in Section 16(1)(c).[551] By virtue of Clause 48, certain management contracts and the details of the persons connected with the person with whom the contract has been made would have had to been notified to the Registrar of Companies. The notices and documents would also have had to have been available for inspection on the same terms as service contracts, are now under Section 26 of the 1967 Act. Under Clause 49 an obligation would have been placed on the director to notify the company of relevant management contracts and the various connections. Under both clauses there would have been criminal penalties for non-compliance.[552] It seems likely that any future companies legislation will contain similar provisions as these.[553]

(II) DISCLOSURE OF DIRECTORS INTERESTS IN SHARES

(a) THE POSITION BEFORE 1967

The Cohen Committee considered that insider trading was both undesirable and improper and should be discouraged by legislation. The Committee considered that the best approach and 'safeguard against improper transactions by directors and against the unfounded suspicions of such transactions' was to ensure 'that disclosure is made of all their transactions in the shares and debentures of their companies'. Given the fact that directors could always be called upon to explain the timing of their transactions once disclosed, the Committee thought that disclosure in itself was a significant deterrent.(554)

It had been represented to the Committee that the requirement that the directors disclose their transactions in the securities of their companies could have adverse effect on the company and fellow shareholders. If a director was forced to liquidate some or all of his holding because of extraneous personal reasons this might, if publicised create the impression that there is bad news about the company in his possession. This would probably be likely to result in a number of induced transactions and thus depress the market falsely. The same argument was raised before the Jenkins Committee. Of course the argument assumes that at least a significant number of investors will take it for granted that the director is trading upon inside information, whether this has an empirical foundation is uncertain. The Committee thought that the fact that disclosure was mandatory 'would tend to negative this false impression, and in the event of a misconception it would always be open to the director to make a statement as to the reasons for his transactions'.(555)

As a result of the recommendations of the Cohen Committee Sections 195 and 198 were included in the Companies Act of 1948.(556) Because a number of Commonwealth countries still retain Section 195 in their Company laws in its original form, and due to the fact that Section 195 has played a significant role in influencing the provisions in many other countries it is relevant to examine, briefly the

original insider disclosure provisions in Britain, which were amended in the 1967 Companies Act. By virtue of Section 195(1) every company, both public and private was required to maintain a register 'showing in respect of each director of the company, not being its holding company, the number, description and amount of shares in or debentures of the company or of any other body corporate being the company's subsidiary or holding company or a subsidiary of the company's holding company, which are held by or in trust for him or of which he has any right to become the holder, whether on payment or not'.(557) The register did not have to include shares in any corporation which was the wholly owned subsidiary of another company.(558) In Section 195(2) it was provided that where any transactions fail to be recorded in the register, 'the date of and price of other consideration for the transaction' must be stated. Where there was an interval between the agreement to buy or sell and the completion the relevant date would have been at agreement.

It was provided that if the director so required the nature of the interest in the securities registered could be included, but that in any case the company was not itself to be affected with notice or placed upon inquiry.(559) The register had to be kept at the company's registered Office, and open to inspection during business hours, subject to such reasonable restrictions as the company by its articles or in general meeting imposed, although not less than two hours in each day the register had to be available for inspection, during the period beginning fourteen working days before the date of the company's annual general meeting and ending three working days thereafter.(560) The right of inspection only extended to shareholders, debentureholders, and persons acting on behalf of the Board of Trade.(561) The register also had to be available for inspection at and during the annual general meeting.

If default was made in having the register available at the general meeting the company and every officer in default was liable to a fine of £50, although if default

was made in complying with the recording and registration requirement or in the inspection or copying provisions the company and every officer in default were liable to a fine of £500 and a default fine of £2.[562] The Court was also empowered to make an order for immediate inspection.

By virtue of Section 195(10) for the purposes of section 195, any person in accordance with whose instructions the directors of the company were accustomed to act would be deemed to be a director of the company and a director of a company was deemed to hold or be interested in any shares of debentures if a corporation other than that company held them or had that interest or right over them and either, that corporation or its directors were accustomed to act in accordance with his instructions, or he was entitled to exercise control over one third or more of the voting power at any general meeting.[563]

Section 198 provided that it was the duty of a director, or a person deemed such, to give a written notice to the company of such matters relating to himself as may be necessary for the purposes inter alia of Section 195. It is interesting that it is provided that if the notice was not given at a meeting of the directors, the director giving the notice must take reasonable steps to secure that it was brought to the attention and actually read at the next board meeting.[564] Failure to comply with this, on conviction, could result in a fine of £50.[565]

When the Jenkins Committee came to consider insider trading, the role of disclosure was obviously an important aspect. The Evidence that the Committee received with regard to Section 195 was mixed and there was considerable disagreement as to the relative merits of the device. The Board of Trade appeared to be reasonably well satisfied with the existing provisions, although it was thought that the register should be available for inspection by shareholders and debentureholders throughout the year.[566] The Committee of London Clearing Banks, took the view that disclosure of directors transactions other than to the board of directors on a continuous and timely basis would

be injurious in that it would encourage speculation and suspicion.[567] Of course this was essentially the same reason that was raised in connection with Section 195. The Committee of London Clearing Banks were also opposed to the extension of disclosure to employees, as they considered that improprieties by such were appropriately the concern of the directors who could take internal disciplinary action against such. Furthermore it is of interest that the Clearing Banks thought that it would be superfluous to only extend disclosure to senior officers and executives as lesser officers and employees would on occasions be equally in receipt of 'inside information'. On the other hand the Banks were not necessarily opposed to the inclusion of a statement of directors transactions over the last year in the annual report.[568]

The Merchant banks in the joint evidence submitted by the Accepting Houses Committee and the Issuing Houses Association, took an opposite view to the Clearing Banks and endorsed the Board of Trades recommendation for extending the periods during which inspection of the register would be allowed, and indeed thought that where listed securities were involved in the transactions, anyone, and not just members or debentureholders should be allowed to inspect the register. The Merchant Banks also thought that directors should be under an obligation to notify the company within three days and that the company should similarly be under a duty to register the transaction within three days.[569] The Merchant Banks also thought that the reporting obligations should be extended to alternate directors and officers.[570] The Federation of British Industry likewise thought that the register should be available throughout the year, and that it should also be publicly available, and not only accessible to shareholders and debentureholders.[571]

Concern was expressed from a number of sources,[572] that under Section 195 a wholly owned subsidiary had to keep a register of its directors shares in its holding company. Where the director was also a director of the holding company the information had to be duplicated in both registers. This was considered undesirable. Given

the doubt that existed as to whether the disclosure provisions comprehended options, there were a number of representations that such should be expressly comprehended.(573) The majority of those giving evidence(574) to the Committee thought that Section 195, was satisfactory. and that disclosure of directors transactions was the preferable approach to insider trading regulation.(575) On the other hand some thought that there was an urgent need to eradicate certain uncertainties in the application of Section 195 and that there was a need for simplification.(576)

In the result, however, the Jenkins Committee was not wholly persuaded that the disclosure scheme envisaged by the Cohen Committee was completely adequate. The Jenkins Committee agreed with the statement of policy by the Cohen Committee that 'the best safeguard against improper transactions by directors and against unfounded suspicions of such transactions' was to require disclosure of dealings.(577) Nevertheless it was thought that there was need for some kind of substantive regulation on insider trading as well. This aspect of the Committee's recommendations will be examined elsewhere. The Committee agreed with those witnesses who had advocated the strengthening and clarification of the disclosure provisions.(578)

(b) THE 1967 COMPANIES ACT

The result of these recommendations was the enactment of Sections 27 to 29 and 31 of the 1967 Companies Act,(579) which replace sections 195 and 198 insofar as the latter relates to Section 195. It is provided by Section 27(1)(a) that except in the case of a wholly owned subsidiary(580) and subject to any regulations made by the Department of Trade,(581) anyone who becomes a director(582) or is already a director when the section came into effect, must notify the company in writing of any interest(583) that he has in the shares or debentures of that company of which he is a director. A similar obligation to report interests applies in the case of such a directors interests 'in any other body corporate, being the company's subsidiary or holding company, or a subsidiary of the company's holding company.(584) Wholly owned subsidiaries are not included, and section 27(13) provides that for the purposes of this section a corporation shall be the wholly owned subsidiary of another if it has no other members but that other company's wholly owned subsidiaries and its or their nominees.(585)

As with Section 195, it is provided in Section 27(11) that 'a person in accordance with whose instructions or directions the directors of a company are accustomed to act shall be deemed to be directors of the company'.(586) The notification required under Section 27(1) must be as 'to the subsistance of the declarants interests at the time in question and of the number of shares of each class of the company' or other body corporate 'in which each interest of his subsists at that time'. Whilst the director remains a director of the company, paragraph (b) of Section 27(1) places him under an obligation to notify the company in writing of the occurrence of a number of stipulated events.(587) These events include, the happening of such an event as to have the consequence that the declarant becomes, or ceased to be interested in the shares in, or debentures of the company or an associated company,(588) the entering into, by the declarant of a contract, to sell any such shares or debentures(589) the assignment by him of a right granted to him by the company

to subscribe for shares or debentures,[590] and the grant to the declarant by an associated company of the right to subscribe for shares or debentures in that other company, the exercise of such a right and the assignment by him of such.[591] In each case the class, number and amount of shares or debentures involved must be stated in the notification. Under Section 27(4) it is provided that there is no duty upon a person to notify the company of the occurrence of an event which comes to his knowledge after he has ceased to be a director.

The Director, obligated to make a notification, must do so within a period of fourteen working days from the 'relevant day' under Section 27(12). The fourteen day period commencing the day after the relevant day. In the case of initial notification under Section 27(1)(a) where the director is aware of his interests, the relevant day is the last previous day before the section came into operation, or the day that he becomes a director. Where at such time the director is ignorant of his interest, the period runs from the 'day next following that on which the existence of the interest comes to his knowledge'.[592] Where the duty involves the notification of a subsequent event under Section 27(1)(b) the director must if at the time the event occurs he knows of its occurrence and also of the fact that its occurrence gives rise to the obligation, fulfil the duty before the expiration of the period of fourteen days beginning with the next day following that on which the event occurs. Otherwise the duty must be complied with within a fourteen day period commencing from the next day following that on which the fact of the occurrence of the event giving rise to the duty comes to the knowledge of the director. It should be noted that from the wording of sub-section 3(b) it would seem that for the period to run the director must have knowledge of the occurrence of the event 'and of the fact that its occurrence gives rise to the obligation'.[593] It is uncertain as to what this actually means, and it is doubtful whether it displaces the normal presumption that a man is presumed to be aware of his obligations under the law.[594] Furthermore it is considered good practice for Company registrars to send report forms to directors on

their appointment, and most companies would appear to at least take some steps to ensure their directors are aware of their obligations in this respect. Confirmation by individual directors of the information in the register about their transactions is often sought as a matter of good practice before the Annual General Meeting.

A person who fails to comply with the provisions of Section 27, or who in purported compliance makes a statement to the company, which he knows to be false, or is reckless as to whether it is true or false is liable on summary conviction to a fine of £200, and or imprisonment for three months, and where the conviction is upon indictment, to an unspecified fine, and two years imprisonment. However, prosecutions can only be brought with the consent of the Department of Trade or the Director of Public Prosecutions.(595)

At the centre of the disclosure regime for directors and substantial shareholders is section 28 which define what interests(596) are relevant for the purposes of Section 27,31 and 33. As with the other provisions in this area of the law Section 28 is exceedingly complex, and most difficult to discuss other than in outline.(597) As a general proposition it is laid down in sub-section (1) that 'references to a person being interested in shares or debentures of a company, shall...be construed as not to exclude an interest on the ground of its remoteness or the manner in which it arises or by reason of the fact that the exercise of a right conferred by ownership thereof is capable of being made in any way subject to restraint or restriction'.598) To this general proposition there are a number of interpretations and qualifications .

It is provided that where a person has an interest in a trust other than a discretionary trust(599) if the trust property comprises securities it will be deemed that the person is interested in those securities.(600) Thus apart from providing a director will be regarded as having an interest within Section 27 in securities registered in the name of a nominee this provision extends the definition of interest to circumstances in which the director has something considerably less than complete beneficial

ownership of the securities concerned.

Furthermore a person will be deemed to be interested in shares or debentures if a corporation is so interested and that corporation or its directors are accustomed to act in accordance with the instructions or directions of that person, or he is entitled to exercise or control the exercise of one third or more of the voting power at any general meeting of the company.(601) Under Section 28(4) a person will be deemed to be interested in the shares or debentures of a company if he enters into a contract for the purchase of such. This provision would overlap with Section 27(1)(b), although it was evidently thought that a contract to purchase shares or debentures which was not followed by delivery might be regarded as falling outside this provision.(602) Section 28(11) states that delivery to a persons order of securities in fulfilment of a contract for the purchase thereof by him or in satisfaction of a right of his to call for delivery thereof or failure to deliver shares or debentures in accordance with the terms of such a contract or on which such a right falls to be satisfied shall be deemed to constitute an event the consequence of which that person ceases to be interested in the securities, and likewise so shall the lapse of a persons right to call for delivery of shares or debentures. Whether this interpretation of the consequences of a delivery or failure to deliver securities under a right or contract is correct, is open to question, and whatever one may think of the statutory drafting of this provision, the important point would appear to be that the fact of delivery or non-delivery is a notifiable event under Section 27(b).(603) Subsection (4) of Section 28, provides that a person will be deemed to be interested in the securities of a company if he has the right otherwise than by virtue of having an interest under a trust to call for delivery to himself or to his order, whether the right is exercisable presently or in the future.(604) The subsection also states that a director will be deemed to have an interest in shares or debentures of an associated company even if he is not a registered shareholder of the securities, 'if he is entitled to ...exercise any right conferred by the holding thereof or is entitled to exercise the control of any

right so conferred'. This could cover the type of situation where a person who enters into a contract to purchase shares cum the right to subscribe for new shares at a price less than the current market price and before he becomes the registered holder transfers the rights to a company which he controls.(605) It is also provided that a director who holds a proxy to vote the relevant shares at a 'specified meeting of the company' or of any class meeting, or who has been appointed by a corporation to act as its representative(606) at any such meeting, will be deemed not to have an interest in the securities such as would require notification. Magnus and Estrin,(607) consider that it follows from this that the holder of a general proxy would have an interest that should be notified.

It is of interest that Section 28(5) provides that persons having a joint interest shall each be deemed to have the interest, and moreover, it is expressly provided in subsection (6) that it is immaterial that shares or debentures in which persons are interested for the purposes of Section 28 are unidentifiable.

Certain types of interest are to be disregarded under section 28. For example the interest of a remainderman or revisioner under subsection (7) or a bare or simple trustee or a custodian trustee, under subsection (8).(608) Those persons who invest in an Authorised unit trust scheme within the meaning of the Prevention of Frauds (Investments) Act 1958 will likewise be excepted with regard to those securities from the reporting provisions. There are other statutory exceptions in subsections (9) and (10) which need not concern this present study. It should be noted that so far Section 28 has not fallen to be interpreted by the Courts, and as academic comment is scarce it is difficult to estimate the exact boundaries of the various provisions.(609) However from the standpoint of the regulation of insider trading it suffices to say that in the vast majority of instances where a director could be considered as interested in a transaction in the securities of his company, it would require to be reported under these provisions.

The power of the Department of Trade to exempt by

statutory instrument transactions from Section 27, has already been mentioned. This provision was introduced in the Report Stage of the Companies Bill 1967 as there was widespread concern that the registers could become 'cluttered up' with too much information that had no real significance.(610) Indeed the Opposition were concerned that the deterrent effect of Section 27 with regard to insider trading would be weakened by the inclusion in the registers of information that was difficult to interpret and generally irrelevant to the regulation of insider trading.(611) There was also the danger that directors would quite honestly fail to comply with the law due to its great complexity and technicality. The Department of Trade has utilised its powers under Section 27)1) in a number of cases, which need not concern us here,(612) except in one respect. Under paragraph 1(1)(a) of the Companies, Disclosure of Directors Interest, Exemption, Number 3 Regulation,(613) it is provided that a director need not make a notification 'to a company which is the wholly owned subsidiary of a body corporate incorporated outside Great Britain, of interests in shares or debentures of that body corporate or any other body corporate so incorporated or any event occurring in relation to such shares or debentures...' This in effect means that a director of a wholly owned English subsidiary would not have to disclose his interests in the securities of a parent company incorporated outside Great Britain, or indeed in any other company incorporated elsewhere than in Great Britain. With the increase in trading of shares in foreign companies on the British Securities markets(614) it would seem that there is a serious risk that directors who have access to confidential corporate information about their parent and associated companies abusing their position and trade on the basis of this information in the United Kingdom completely uninhibited by Section 27. That this type of conduct occurs, cannot be doubted.(615) There is of course no problem with regard to the British subsidiary, as by virtue of it being wholly owned obviously there is no possibility for insider trading at least insofar as its equity capital. The Head of the Quotations Department of the Stock Exchange, and the

Secretary to the Quotations Committee,[616] both favour disclosure of transactions in the foreign holding company and its associated companies as a matter of principle but are dubious as to the feasibility of enforcement. Whilst it was accepted that it might be possible to extend the disclosure obligation through the listing agreement, the Head of the Quotations Department thought that this was unlikely as the reason behind the Department of Trade granting the exemption in the first place was to alleviate the burden on British directors as compared with foreign colleagues. Whilst this appears reasonable at first glance, it is necessary for directors to report their transactions in the securities of their companies in a great number of countries, and thus to impose the disclosure obligations under Section 27 on directors of such a subsidiary would not necessarily be unfair or anomalous. It should also be noted that from the wording of paragraph 1(1)(a) it is at least arguable that all companies incorporated outside the United Kingdom are excluded from Section 27, as the relevant provision states that the exemption applies 'to that body corporate' that is the parent company', or any other body corporate so incorporated'.

The last in the 'trilogy' of sections designed to replace section 195, and the relevant part of Section 198, is section 29.[617] This provides that every company must keep a register for the purposes of Section 27, and whenever the company receives information from a director in consequence of the duty imposed upon him by that section the company is placed under a duty to inscribe it in the register of directors interests in securities, against the name of the relevant director.[618] However every company is also under an obligation without such notification, to record in the register, against the relevant name of the director the grant of a right to subscribe in the securities of the company to a director. Under Section 29(2)(a) it must also record the date on which the right is granted, the period during which or the time at which it is exercisable and consideration for the grant, or the fact that there was no consideration, the description of the shares or debentures concerned,

the number or amount and price to be paid for them. Where a similar right is granted to a director by an associated company, the obligation is upon the director to notify the company under Section 27(7).(619) Paragraph (b) of subsection (2) requires the company to inscribe in the register, whenever the right is exercised, the number or amount of shares or debentures in respect of which the right was exercised, if they are registered in the directors name, and if they are not the names of the persons they are. It should be noted that the duty of inscription placed on companies under Section 29(2) applies to every company whether a principal or an associated company that grants the right.(620)

The register must be made up so that the entries contained therein are in chronological order,(621) and an index must be maintained with the register.(622) In the case of both the duty on the company arising by notification on the part of the director, and in the case of the company granting rights itself to the director, the obligation to inscribe the information in the register must be completed before the expiration of three working days beginning with the day next following that on which it arises.(623) As in the case of Section 195(3) subsection (5) of Section 29 enables a director to require that the nature and extent of any interest in the relevant securities be included in the register, although similarly to Section 195(4) it is provided in Section 29(6) that the company will not by virtue of anything done for the purposes of this section be affected with notice or put upon enquiry as to the rights of any person in relation to the securities concerned.

Although the Section makes detailed provisions as to where the register of directors securities interests is to be kept, as a general rule it must be kept with the register of members if such is kept at the registered office,(624) although where the register of members is maintained elsewhere the register of directors interests could, at the company's discretion be kept with it or at the registered office. Where the register is not maintained at the company's registered office notice must be sent to the Companies Registration Office as to its location.(625)

The register of directors interests in securities must be open to inspection during business hours subject to such reasonable restrictions as the company in general meeting may impose, so that not less than two hours each day are to be allowed for inspection by members of the public for a maximum fee of 5p or in the case of shareholders freely. It should be noted that debentureholders must pay the statutory fee, unless the company waives it. As a matter of good public relations inspection of the register is allowed freely in all cases. Previously copies of the register could only be demanded from the Department of Trade, but now under Section 29(10) any member of the company or any other person may demand a copy of the register or any part thereof, on payment of 10p or such lesser sum as the company, which here in effect means the directors may prescribe, for every hundred words or fractional part of a hundred words required to be copied. The company must cause the copy to be sent to the person concerned within a period of ten days beginning with the next following that on which the request was received by the company. It is dubious as to whether a person inspecting the register is allowed to make his own extract. The practice of registrars on this point differs and although it would seem many would turn a blind eye to an enquirer jotting down a few facts, others as a matter of policy will not allow this. There have been cases where cassett tape recorders have been used to record extracts, and even cameras. Although little criticism can be made of the relatively small fee charged by the company for copying extracts the main problem is that the company can delay in providing the requested information for up to ten days. This can be a serious problem where detailed information is required as a matter of urgency, such as by financial journalists or officials. With the availability of photocopier facilities in most companies perhaps an obligation should be placed upon companies to provide the extract as soon as possible, but in any event not later than ten days. Certainly many registrars will furnish photo-copies almost on demand as a matter of courtesy.

Under section 29(11) the register must be produced at the commencement of the company's annual general meeting

and remain open and accessible during the continuence of the meeting to persons attending the meeting, seemingly whether such are actually entitled to attend the meeting as of right or not, as for example in the case of journalists. It is somewhat anomalous that the register is only available for inspection at the annual general meeting as in many instances where the register would be of relevance such as in an extraordinary general meeting called to authorise the increase in capital for a takeover or other major corporate development the register is not required to be made available. Of course as a matter of good investor relations there is nothing to stop the register being made available during such meetings. If default is made in providing the register at the annual general meeting the company and every officer in default is liable on conviction to a fine of £50.(626) If default is made in complying with the other provisions of the section the company and every officer in default is liable to a fine of £500 and a further default fine, which by virtue of Section 440(1) would amount to £5 a day. It should be noted that all offences here are triable summarily and the only penalty is a fine. Of course it is possible to seek a court order where inspection or a copy is refused.

The scope of these disclosure provisions has been extended considerably by Section 31 which for the purposes of Section 27 treats the interests of a director's spouse and children as his own interests.(627) It is important to note that by virtue of Section 31(6) the extended obligations imposed by section 31 for the purposes of Section 29 will be treated as though they were imposed under Section 27. It is provided by Section 31(1)(a) that an interest of the wife or husband of a director of a company, not him or herself being a director of the company, in the shares or debentures of the company shall be treated as being the directors interest. Likewise the interest of an infant child, including a step-child or adopted child,(628) of the director of the company, the child not being a director of the relevant company, in the shares and debentures of the company will be regarded as the directors. Furthermore a contract, assignment or right of subscription entered into, exercised or made by, or grant made to the

spouse or infant child shall be treated as having been entered into, exercised or made by or to the director.[629] Under Section 31(2) a director of a company is under an obligation to notify the company in writing of the occurrence whilst he is a director, but not before or after such, of the grant to his spouse or infant child, by the company of a right to subscribe for securities of the company, and the exercise by his spouse or infant child of such a right, stating in the case of a grant of the right, the same information as is required by Section 27 to be stated in the case of the director personally on the grant to him by an associated company of the right to subscribe in the shares or debentures of that company, and similarly in the case of an exercise of such a right the same information as he would have had to disclose in such a case under Section 27.[630] Moreover an obligation imposed by section 31(2) must be complied with by the director, within a period of fourteen days as commencing from the day next following that on which the occurrence of the event that gives rise to the duty to notify the company 'comes to his knowledge'. This provision should be compared with the sister provision in section 27(3)(b). In section 31 it is necessary only that the event giving rise to the duty is in the directors knowledge, and there is nothing akin to the phrase in Section 27 that he must also know that the event gives rise to an obligation to notify the company.. Whether this in practice makes any difference has already been doubted. If indeed it does, it would appear anomalous that the additional protection was not extended to directors under Section 31 where the degree of complexity and technicality is that much greater. Any person who fails to comply with this section, or who in a purported compliance intentionally or recklessly makes a false statement to the company is liable to the same penalties as under Section 27(8).[631]

Of considerable interest is the amendment proposed by Mr.J.Bruce Gardyne M.P. to the 1967 Companies Bill during its Second Reading.[632] This amendment which was defeated, would have provided another section, which

would have required directors and officers of quoted companies which had over one hundred members, to notify the Department of Trade within ten days of the end of each calendar month of the occurrence of any such event as is stipulated in Section 27. The notification apart from requiring details as to the event and the number of securities involved would have required the inclusion of details as to the nature of ownership involved: The information received under this provision would under the proposed provision have to be published on a monthly basis by the Department.

Mr. Gardyne, with the support of Mr.Michael Shaw M.P. emphasised that this provision was designed to prevent directors, using 'their knowledge of forthcoming events which are liable to affect the value of the shares of the company to effect a bargain with a member of the public who is not so informed to the disadvantage of the other'.(633) Whilst endorsing the Governments provisions on insider disclosure, the Opposition thought that by the time that the information appeared in the register and such had been inspected(634) it was likely that considerable time would have elapsed since the occurance of the event. The much more timely disclosure with the wider degree of disemination suggested in the Oppositions amendment was thought to be a much greater deterrent for insiders to abuse their position; Mr.Gardyne M.P. stated 'the mere fact of publication would be a very effective deterrent to misbehaviour by the small minority of insiders...who might be inclined to misbehave'.(635) Apart from being of assistance to the general body of shareholders, Mr. Gardyne M.P. thought that the proposed amendment would greatly assist the financial press in their role as 'guardians' in this field.(636)

On the other hand the Opposition accepted that it would be wrong to impose a too heavier burden on the Department of Trade. Mr. Gardyne M.P. evidently consulted the American Securities Exchange Commission on the cost and resources involved in publishing information on insiders tradings, and concluded that proposed amendment would definitely not place a disproportionate burden on the

Department.[637] Similarly upon the basis of the experience in the United States the additional burden on companies was not over excessive. The President of the Board of Trade had expressed some support for the proposal during the Committee Stage of the Bill and the Minister of State stated that the Government were disposed to favour the proposal, during the Second Reading.[638] However the Minister thought that it would not suitably fit in with the present bill and would be more suited to the promised second instalment of company law reform.

It should be noted that the proposed amendment extended to officers as well as directors, Mr.Gardyne thought that 'it is a little equitable to place a special burden on directors which is not placed on officers who may in fact be in a much better position to make use of inside information than the directors are'.[639] Mr.Gardyne did not seek to define the term 'officers' and the President of the Board of Trade declined to express his views on the matter.[640] Other Honorable Members however expressed opposition to the proposed inclusion of officers because of the definitional problem.[641]

Mr.Gresham Cooke M.P. thought that the proposed amendment was 'a very strong Socialist hammer to crack what may be a very small nut, wielded by a right-wing Tory'.[642] Mr. Cooke thought that it would be preferable if the Stock Exchange published this information, although he conceded that it was unlikely that this would be considered feasible in the short term.[643] Mr.Stainton M.P. suggested that it was likely that a private publisher would soon hit upon the idea of gathering the requisite information and publishing it periodically.[644] It is not without interest that the City of London Solicitors Company in their Report on Insider Trading considered whether insiders transactions should be published in the press. This approach was rejected on the ground that the vast majority of transactions were totally unobjectionable and 'publication would open the door to troublesome enquiries about purchases or sales which do not call for any enquiry'.[645] It was also thought that there would be a certain amount of 'induced or emulative' trading; noticeably the two

major arguments raised before the Cohen Committee and Jenkins Committee and in both cases rejected.

(c) IMPROVEMENTS TO THE 1967 SCHEME

The insider disclosure provisions in the 1967 Companies Act have not escaped a certain amount of criticism.(646) Apart from the complexity of the drafting there has been evidence that the administration of the provisions by the companies concerned, had been deficient.(647) Furthermore whilst there is much weight in the argument advanced by Mr. David Ennals M.P. during the Second Reading of the Emoluments of Top Management, Disclosure and Regulation Bill 1965, that 'if the information was revealed there would be much less danger that people would think that there was any jiggery pokery' going on,(648) the cynical comment of Sir H. d'Avigdor-Goldsmid M.P. in reply, to the effect that it is the very people who would think that 'jiggery pokery' was going on, who would not be satisfied with the information disclosed still remain axiomatic.(649)

Concern has been expressed that the information contained in the registers is 'practically inaccessible' to the average shareholder, who has neither the time nor inclination to check the register himself, and that a greater effort should be made to ensure that the information therein contained is sent directly to members with the annual accounts.(650) The Parliamentary Under-Secretary of State for the Department of Trade and Industry, Lord Limerick, in response to such a demand in the House of Lords stated that the Conservative Government was alert to this matter and were studying the problem in the context of their reform of company law.(651)

Of course the Jenkins Committee abandoned the approach of relying solely on disclosure to combat insider trading and recommend substantive prohibitions. Whilst the 1967 Act, apart from option dealings continued the disclosure approach, the then Labour Government promised substantive regulation in their projected second instalment of company law reform, which through force of events never materialised. The Conservative Government in their White Paper 'Company Law Reform' endorsed the view that it was now fallacy to trust solely disclosure in the regulation of insider trading.(652) Because of the recommendations contained in the White Paper for substantive regulations, the

existing disclosure provisions would have assumed a new aspect, that of an aid to enforcement. In this respect the Government considered that it was necessary to strengthen the provisions to assist in detection of insider trading activity. The main defect of the present system in the view of the Conservative Government was that a director did not have to inform the company for a period of fourteen days and then the company has a further three days to inscribe the information in the register. Furthermore apart from the register in the company's office there is no other source of public disclosure. The White Paper considered that the notification period must be reduced to 'the shortest practical period'. The Council of the Stock Exchange extended the offer that if the directors concerned of listed companies made a simultaneous disclosure to the Exchange, the Stock Exchange would publicly announce it.(653) The comments of the White Paper were embodied in Clause 17 of the Companies Bill 1973.

Sub-clause (1) of Clause 17 would have reduced the period of notification from fourteen days to three(654) and under sub-clause (2) where the notification relates to listed securities there is an obligation on the director to notify the Stock Exchange in the same manner as the company, and within the same period of time. It was further provided that 'the Stock Exchange may publish, in such manner as it may determine, any information received by it under this provision'. These improvements on the 1967 Acts insider disclosure mechanisms were reasonably well greeted and Mr. Michael Shaw M.P. considered tham a significant advance in the regulation of insider trading.(655) However it is important to note that the insider disclosure provisions were not matched with the substantive regulations in Clauses 12 to 16, and which will be discussed later on. For example there was considerable divergence as to the definition of insiders under the disclosure provision and that under the regulatory clauses. Of course this divergence is not necessarily either novel or anomalous as the experience of the United States law on this point shows. Another point of interest is that the disclosure mechanism for substantial shareholders under Section 33, although not intended or designed as an insider disclosure device would have become

such by virtue of Clause 12 which rendered substantial shareholders insiders. The object of Section 33 was and is of course to provide a disclosure mechanism for control and potential control concentrations, and not for insider trading disclosure.(656) Professor Gower(657) and Professor Loss,(658) compare the situation in Britain to that in the United States and point out that in the latter both mechanisms for disclosure are directed at insider trading. With the greatest respect this is erroneous as it neglects the role of Section 13(d) of the Securities Exchange Act 1934, which corresponds to section 33.

Reference should also be made to the power, that would have been given to the Secretary of State for Trade under Clause 69 to prescribe the matters to be disclosed in the accounts, directors and auditors reports, and the annual returns under statutory instrument. So far as the directors report is concerned the matters to be covered were set out in schedule 1 of the Bill. This schedule included details of the directors interests and those of his family in contracts with the company and in the company's securities as well as options, and rights of subscription. Similar information must also be included as to associated companies.(659) Furthermore Clause 69 expressly provides that if any regulation issued by the Secretary of State required the inclusion in any note, account or report of matters relating to the directors, officers and employees of the company the Secretary of State could stipulate that it is the duty of such persons to provide the information to their company under penalty of a £200 fine in case of default. It would seem that the Secretary of State could well have sought to require the inclusion in the accounts, reports and annual return of information specifically related to insiders transactions.(660) Of course notification in the annual returns of the shareholdings of directors as required under the present law is some protection against insider trading as it is possible to see to what extent insiders had been trading during the past year, and if suspicions are aroused reference can then be made of the register at the company's offices.(661) The City of London Solicitors Company in their Report on Insider Trading

considered that particulars of all changes in the register of directors interests in securities since the date of the last accounts should be sent to all members and debentureholders of the company, with the annual accounts and directors report.(662) As has been pointed out previously during the passage of the 1976 Companies (no 2) Bill considerable pressure was brought to bear on the Government to introduce the anti-insider trading provisions in the 1973 Companies Bill into the proposed legislation. The Government, did acknowledge that there was a need to improve the disclosure mechanism, and acceded to the Oppositions request to adopt in a modified form Clause 17 of the 1973 Bill. In the result Section 24 of the 1976 Companies Act requires directors to make the notification under Sections 27 and 31 of the 1967 Act within five days. Under Section 25, where a company that has securities listed on the stock exchange receives a notification under these provisions, relating to quoted securities the company is under an obligation to notify the stock exchange of that matter and the stock exchange is empowered to publish in such manner as it may determine any information received under this provision. The company must comply with this obligation within one working day of receiving the directors notification, and in the event of non-compliance a fine of £500 and a further default fine is prescribed for the company and every officer in default.

(D) DISCLOSURE DIRECTLY TO SHAREHOLDERS

(a) THE SCHEME OF DISCLOSURE

There can be little doubt that disclosure and dissemination of information is most effective when sent directly to the intended recipients directly. The disclosure mechanisms provided by the Companies Registration Office and the registers maintained at the company's office both require a conscious effort and desire by the investor or enquirer to obtain the information, and in reality this will only occur where suspicions have already been aroused.(663)

This area of the law relating to disclosure is highly complex and of a technical nature given the fact that the medium of disclosure here is primarily through the accounts and financial statements. Bearing this in mind and the fact that this particular area is adequately dealt with in virtually every book on company law, only brief attention will be given to the structure of this disclosure mechanism. The basic vehicle for direct shareholder disclosure in the Companies Acts is section 1 of the 1976 Act, which replaces section 148 of the 1948 Act.(664) This section requires the directors, under threat of penalty, to lay before the general meeting both a profit and loss account for the last accounting reference period with a balance sheet. The basis for these two accounts is of course the books of account that are required to be kept under section 147. Under section 148(1) the profit and loss account had to be 'made up' to a date not earlier than of the meeting by more than nine months or in the case of a company carrying on business or having interests abroad by more than twelve months. Section 1 now requires presentation within seven months of the close of the relevant accounting reference date,(665) or ten months in the case of a private company. Where the company carries on business abroad this period may be extended by a further three months.(666) Thus even under the new provisions at the time that the accounts are presented to shareholders and sent to the Registrar they are likely to be very much out of date.

The Institute of Chartered Accountants in their evidence to the Jenkins Committee, stated that 'the primary purpose of the annual accounts...is to present information to the

proprietors showing how their funds have been utilised and the profits derived from such use. It has long been accepted in accounting practice that a balance sheet prepared for this purpose is a historical record and not a statement of current worth...similarly a profit and loss account is a historical record.(667) Furthermore it must be appreciated that 'a balance sheet gives only a snapshot at a single moment in time'.(668) The historical costs basis in corporate accounting whilst endorsed by both the Cohen and Jenkins Committee has become increasingly questioned in recent years with the rampant degree of inflation which works to render the traditional approach highly misleading.(669) This factor has emphasised the importance of the realisation that accounts are primarily directed to professional advisers.(700)

It is specifically provided in Schedule 8 that various matters may be stated in a note to the accounts rather than in the accounts themselves. If the information is included in other documents such as the directors report such must be annexed to the accounts, and the auditors must report on such matters as are within the requirements of the accounts.(701) Copies of the accounts, the auditors report thereupon and the directors report, which will shortly be examined, must be sent to every shareholder and debentureholder at least twenty one days before the general meeting whether such persons are entitled to receive notice of the meeting or not.(702) But all persons entitled to receive a notice must be sent the information. Of course most public companies, and a large number of private companies as an exercise in investor relations prepare an integrated booklet containing the required information and a certain amount of voluntary information and explanation, such as the Chairmans address to shareholders. A number of companies in addition pay to have the annual report and accounts or extracts therefrom published in the national press, again largely as a matter of prestige and public relations.

The directors report in recent years has become a most important medium for disclosure, as it provides the relevant information in a much more descriptive and readable way. Indeed Professor Gower has advocated that

the accounts and financial information should be presented in a consecutive form in narrative style and incorporated as an integral part of the directors report.(703) Under the present law Section 157(1) provides that there shall be attached to every balance sheet laid before the General Meeting a report by the directors with regard to the state of the company's affairs, the recommended dividend and the amount to be carried to reserve. Furthermore, as has just been stated it is also permissible under Section 163 to include any information required to be stated in the accounts in the directors report, which would then be treated as annexed and part of the accounts to the extent that it contains mandatory information. The Jenkins Committee was concerned that directors reports were becoming too formalised and uninformative, and that the bulk of important information that investors needed was often being included 'informally' in the Chairmans address, which was not always available to investors in a published form.(704) The Committee to remedy these problems recommended an upgrading of the directors report and the Chairmans statements. The Government accepted certain of the recommendations of the Jenkins Committee, with the result that the informational content of the report is today, in the words of the editors of Palmer 'extraordinary diverse'.(705)

There would be little utility in entering into a detailed discussion of the content requirements of the directors report, as this aspect is adequately covered by the standard works,(706) furthermore, reference has already been made to the provisions in Section 16 relevant to directors conflicts of interests and interests in contracts and transactions with the Company.

Under Section 16 the report must state the names of the persons who were directors of the Company during the relevant financial year, the principle activities of the Company and that of its subsidiaries, and any significant change in these over the last year. In addition significant changes in the fixed assets of the Company and its subsidiaries, and the details with regard to the issuance of shares and reasons for so doing are required to be stated, as well as contracts of significance in which a director is or was interested, as has already been alluded

to. Similarly any arrangement under which a director is or can acquire shares or debentures from the Company or any other corporation is to be disclosed.

Of particular significance from the point of view of insider trading is Section 16(e) which provides that with respect to each person who at the end of that particular year was a director of the company, the report must state whether or not according to the register kept by the Company for the purposes of Section 27, he was at the end of that year, interested in shares or debentures of the Company or of any other Company in relation to which he was under an obligation to report his transactions and interests under Section 27. If a particular Director is so interested the number of shares or amount of debentures of each corporation at the beginning of the relevant financial year or when he became a director must also be stated. Thus it should be noted that Section 16(e) only requires that the total holdings of the directors individually both at the commencement and at the end of the relevant financial year be stated. There is no requirement as has already been mentioned that the report should disclose details of the directors actual transactions.(707) The Stock Exchanges Listing Agreement requires companies to supply the same information as is required under Section 16(e) but in addition provides that non-beneficial interests must be distinguished from beneficial, and furthermore the statement 'should include by way of note any change in those interests occurring between the end of the financial year and a date not more than a month prior to the date of the notice of the meeting or if there has been no such change, disclosure of that fact'.(708) It has been suggested that the company's stock broker should be placed under a statutory responsibility to report on the dealings of directors, their spouses, infant children and 'persons acting in concert' in the company's securities in the same manner as an auditor. The brokers report and a full account of all the 'insiders' transactions would appear in the annual report and accounts.(709)

It is provided by Section 16(f) that the directors report must contain particulars of any matters other than those specifically mentioned so far as they are material for the appreciation of the state of the company's affairs by its

members, being matters the disclosure of which will not in the opinion of the directors be harmful to the business of the company or of any of its subsidiaries. Although information as to substantial shareholdings are not specifically required to be stated in the report, those that are notified under section 33 are generally included under this discretionary provision. The Stock Exchanges Listing Agreement does require disclosure of ten per cent shareholders of any class of voting capital, however.[710]

Under the other sections in the 1967 Companies Act relating to the directors report, information with respect to political and Charitable donations must be included and with respect to certain companies the average number of persons employed by the company and their aggregate compensation.[711] Certain companies that are engaged in more than one class of business during the relevant financial year must state the turnover from each class and the extent to which 'in the opinion of the directors' each class of business contributed to the company's pre-tax profits. Similar information has to be disclosed if the company has subsidiaries and thus submits group and consolidated accounts.[712]

(b) ACCOUNTS AS A MEDIUM OF DISCLOSURE

Professor Gower correctly observes that 'published accounts have become the lynce pin of the system of protection through disclosure'.[713] In recent years there has been a growing awareness, and not only in the United Kingdom, that the traditional presentation of financial information is deficient both in content and in form. This problem has already been alluded to in connection with 'inflation accounting'.

There have been numerous and persistent calls for the simplification and clarification of accounting procedures and presentations, and for the improvement in the quality and utility of financial information provided therein.[714] One of the major problems has been that accounts have been orientated to the 'stewardship' approach which developed in an era when there was much less separation between ownership and management, than there is today. The stewardship approach is based on the hypothesis that to a certain extent both the managers and owners are 'insiders' and thus require a different type and presentation of information than do the essentially outsider shareholders in the public companies of today.[715] The problem has been compounded by the different, and often contradictory informational needs of various groups to which the management owe a legal or practical duty of disclosure to.[716] Obviously a critical evaluation where diverse informational needs are required to be satisfied is the question of materiality.[717] Also because of the traditional reliance in the accountancy profession on practical considerations rather than in research and the development of a underlying science or philosophy of accounts there exists a plethora of princi ples and procedures, and a significant lack of uniformity.[718] Because the application of varying, although perfectly legitimate and respectable, procedures and principles of accounting practice, to a given set of facts can result in astounding divergences in result,[719] there have been numerous and exceedingly serious problems.[720] The difficulties are all the more as the directors of the company are the ones to decide upon which principles are employed in any particular case. Given this there is

little wonder that there have been occasions where it has been alleged that managements have manipulated accounting principles to suit their own purposes.[721] There has also been considerable criticism of the way in which auditors have performed their expected role as 'watchdogs'. The vital independence of auditors, and their ability to stand up to managements has proved defective in a disturbing number of instances.[722] Of course it has been stated that auditors could exercise a role in the detection of insider trading, but this is doubtful. It has been authoritively stated that 'an auditor is not bound to be a detective...he is a watchdog, but not a blood hound...if there is anything to excite suspicion, he should probe it to the bottom, but in the absence of anything of that kind he is bound to be reasonably cautious and careful.[723] Unless the matter is in some way connected to a statement in the accounts it would seem that the auditor has no responsibility, although it would seem an auditor should detect illegal payments and self-dealing.[724]

Even where there is a proper degree of disclosure in the financial statements it is possible that the presentation will be such that it is difficult to obtain a full appreciation of the information so disclosed.[725] Furthermore, where investor disclosure is concerned the primary need is for information that will assist in forecasting and estimating the future dividend stream and risk factor. Thus it has been stated that the traditional presentation of accounts which concentrates on past achievements are of a deficient nature in themselves. From this argument, that has much to commend it, it would appear that accounts should focus to a much greater extent on projections and profit forecasts.[726]

As the ability to compare the relative merits of securities is at the heart of a market philosophy it is both desirable and necessary that the particular merits of a security should be presented in a manner uniform with the presentation of others. With the divergence in accounting principles and procedures this has not been the case.[727] Attempts have recently been made to achieve a degree of uniformity on an International basis.[728] Of perhaps greater immediate significance is the development in Britain of a system of standard accounting practices.[729]

The Institute of Chartered Accountants for England and Wales with the support of the other accounting bodies and other self regulatory agencies, such as the Stock Exchange[730] announced its intention in December 1969 of intensifying its efforts to minimise the areas of divergence, whilst at the same time not imposing a rigid uniformity.[731] The Institute emphasised that apart from promulgating standard accounting practices, which would embody proper accounting practice, and deviation from which would have to be justified, it would establish an ongoing research programme and 'strengthen its machinery for investigating and pointing to lapses from the standards. 'The Institute established an Accounting Standards Steering Committee which was charged with the drawing up and administration of this 'quasi-law'.[732] The standard Accounting Practices which this body has promulgated[733] are much more authoritative than the old Recommendations on Accounting Principles that were put out by the Institute which were little more than advisory commendations representing the standard practice of the larger accountancy firms. Although there have been suggestions for the establishment of some regulatory agency to lay down legal rule in this area, the bulk of opinion would seem to be in favour of the present self-regulatory scheme continuing.[734]

(c) EFFECTIVENESS OF FINANCIAL DISCLOSURE

It is of course a somewhat obvious, although often neglected truth, disclosure without comprehension on the part of the intended recipient is meaningless. Professor Gower has commented that 'unfortunately, accounts in general and those of companies in particular are of little immediate help, except to the well instructed, who are least in need of protection. To the average investor or creditor they are cryptograms which he is incapable of solving.[735] This has been born out empirically on a number of occasions. For instance in a recent survey by T.A.Lee and D.D.Tweedie,[736] it was found that exceedingly few shareholders had any significant degree of comprehension of the information presented to them, less than half had any idea of the usual method of valuing assets or even where the responsibility for the financial statements lay.

Apart from the intrinsicly difficult concepts and figures in accounts the presentation of such largely contributes to the unreadability of such. Obviously there is little one can do in connection with the difficulty of the subject matter as this is primarily a matter for investor and user education,[737] but attempts can be made to achieve simplification and clarification of presentation, as has already been pointed out. A number of learned writers have sought to distinguish between essentially two different types of disclosure. There is that type which is aimed at the unsophisticated investor who would be 'ignorant' of accounting procedures and principles, and on the other hand there is that category of disclosure that is directed at the professional investor and professional advisers who can or at least should, understand disclosure through accounting procedures.[738] Professor Homer Kripke on a number of occasions has criticised the actions of the Commission and the profession in trying to tailor disclosure to the needs of the unsophisticated user.[739] Apart from the impracticality and probable impossibility of achieving comprehensibility for this class of user, the learned Professor points out that the prudent although unsophisticated investor 'who tries to act in an informed

way does so by getting at least part of his information second hand, filtered through professionals'.[740] Kripke castigates the view that non-professional investors could effectively utilise such financial statements as prospectuses as a 'delusion'.[741] It should also be noted that it is probable that even professionals obtain the bulk of their 'investment information' from sources other than the formalised disclosure and reporting provisions.[742] Kripke concludes that the disclosure mechanisms should be directed primarily to the professionals and their advisers, and thus the information therein contained should respond to their particular needs. Thus considerably more emphasis should be placed on the disclosure of financial data.[743] Whilst this is no doubt logical, and perhaps desirable the extremely privileged position that financial advisers would be placed in should be noted. Furthermore small investors would not often have the required degree of access to professional expertise and advice. Whether the plight of the small investor is determinative of the question is beyond the scope of this discussion insofar as it rests on policy considerations.

(d) DISCLOSURE AT THE TIME OF PUBLIC ISSUE OF SECURITIES

The law has long recognised the particular opportunities for abuse and unfairness where securities are issued to the public, and has required a searching degree of disclosure.(744) The notion is aptly stated by Professor Pennington in the Investor and the Law,(745) where he points out that directors and promoters, in the issue of securities, are in a position similar to that of a dealer in specialised goods; 'they have the means of ascertaining the facts about the company's history, financial condition and prospects and distribution of powers to control or influence the conduct of affairs of the company' and thus it is not unfair to impose such a duty of disclosure. Furthermore as States have a vital interest in preventing the diversion of scarce capital into false or 'unworthy' enterprises most countries have not been slow to enact provisions dealing with the disclosure of material information at the time of issue.(746)

Obviously it is not possible to deal with the various legal and extra legal disclosure requirements with regard to the public issue of securities here. It is only necessary to point out that under the Companies Acts and the requirements of the Stock Exchange searching disclosure is generally required as to both the nature of the proposed investment and the interests that insiders might have therein.(747)

It is important here to mention the 'so called' Unnumbered Directive which relates to the contents of prospectuses published on the admission of securities to the official lists of a Stock Exchange of a Member of the European Economic Community.(748) The E.E.C.'s Commissions Explanatory Memorandum, states that at present the disclosure requirements when securities are to be granted a quotation on a Stock Exchange are 'sometimes considerably different in content and in legal basis, from one member state to another'.(749) Thus in consequence 'issuers provide information which varies remarkably in both quality and quantity, and the protection afforded to the investor in this respect is not everywhere the same. 'With the increased freedom of movement of capital already achieved under the Directives issued under Article 67 of the

Treaty of Rome, it is highly desirable that there is at least a semblance of equality of information in the Community.(750) Without a degree of equality the informational imbalances produce a situation not unsimilar to that where insider trading occurs. Of course any investor who decides to invest in a foreign country must accept that the degree of disclosure may be different to that he could expect in a domestic situation, indeed the nature of the foreign market may be entirely dissimilar. Furthermore given the divergence in language and possibly in accounting procedures(751) the disclosures that are made may not be over helpful.

The Commissions Explanatory Memorandum comments that 'the incomplete and differing nature of the information which the public receives concerning securities constitutes a 'serious barrier' to the movement of capital between member states, and prevents full advantage being taken in the operation of the capital markets of the abolition of exchange restrictions which has already taken place'.(752) In the Commissions mind 'the capacity of the markets is often seen as the basic reason for their narrowness and instability', and a harmonisation of disclosure would therefore facilitate the markets and increase the flow of capital. It was also found by the Commission that the present imbalances of both disclosure and enforcement distorted the choice of stock exchange to which companies directed their applications for listing.

Whilst accepting that the proposed harmonisation of requirements would not eradicate different standards in practice, and that in any case the standard imposed by the Directive fell short of that already required by the British Stock Exchanges, the Commission thought that there could be little doubt that overall there was advantage in their recommendations. The Directive provides that a prospectus checked by the appropriate authority must be published in all cases before a security is admitted to the official lists of a stock exchange.(753) It should be noted that the Directive comprehends only official stock exchange markets, as it was thought that to step beyond this on a Community wide basis would be impractical given the diversity of other markets. Moreover, it should also be noted that the provisions apply to all corporate issuers

seeking a listing and not only domestic corporations. The Explanatory Memorandum states that 'the prospectus...must contain all the information which, according to the particular nature of the issuer and the securities in question is necessary to enable the investors and their investment advisers to form a well founded opinion on the net worth, financial situation, results and prospects of the issuer and also on the rights pertaining to the securities for which the application for admission to quotation is made. 'The Commission make it clear that this is the standard that the appropriate regulatory authority should apply in determing the suitability of the prospectus. It is not without interest that the prospectus should not be so simplified so as not 'to provide such details as to allow professionals to have full knowledge of the fact when advising the public or taking investment decisions on their behalf'.(754) To this end the Directive provides that Member States should ensure that the admission prospectus contains in an 'easily analysable form and as comprehensible as possible at least those items of information listed in the Schedules' to the Directive.(755) Whilst the word 'harmonisation' has been used it would appear that in this instance the Commission is more concerned with achieving a degree of 'substantial equivalence, which is essential if the public is to have confidence in the prospectus. 'The stipulated provisions in the Directive for inclusion in the prospectus are of course the minimum criteria and there would be nothing to prevent a Member State requiring additional information. Moreover, the form of the prospectus is not prescribed, and this is thus in the discretion of the relevant national authority, although there is a duty to ensure the prospectus is easily readable.(756)

Obviously of critical importance is the relevant national agency charged with the administration and supervision of prospectus disclosure. The Commission whilst making it clear that this body can be of either a public or private nature, emphasise that it must have adequate powers to demand additional information and enforce the requirements.(757) It is of interest to note

that Article 17 provides that every important new event arising between when the prospectus is finalised and the commencement of dealings must be notified in a supplementary prospectus, similarly checked and published. In the Explanatory Memorandum, the Commission make it clear that only events that would be likely to influence the public's evaluation of the securities need be included in this provision.(758)

Where securities are to be admitted to several lists, in different member states, the authorities of the countries concerned are placed under an obligation to co-ordinate with each other, and obtain equality of disclosure and simultaneous release of such.(759) The European Stock Exchanges have already reached agreement on the potentially troublesome question of suspension, where a particular security is listed in more than one country. It has been agreed that where any stock exchange upon which the relevant security is listed in the country in which the company is registered, suspends the quotation, for any reason, all other Stock Exchanges in the E.E.C. will suspend dealings in that security for a period of forty eight hours. During this period of time it would be possible to decide upon a concerted course of action. The European Stock Exchanges also have a number of informal agreements to the same effect with Exchanges such as the New York Stock Exchange and Johannesberg Stock Exchange, outside the E.E.C.(760)

The Commission also thought that it would be desirable to establish a Contact Group within the Commission, which could assist the various national agencies in their interpretation and administration of the Directive and ensure a degree of uniformity. The Group would consist of representatives of both the national regulatory agencies and the Commission itself, with a secretariat provided by the Commission. This would appear to be an embryo Euro-S.E.C., as the Group apart from agreeing upon uniform policies would be charged with advising the Commission on further matters germain to the Directive and the protection of investors.

The information required to be contained in the prospectus under the Schedules is reasonably searching.

There are, however only a few provisions that are of interest to this present discussion. Schedule A, Chapter 3, paragraph 2.6 requires information as to persons who are directly or indirectly alone or jointly with other in control of the company, and the extent of their holdings. Furthermore information must be included with regard to persons holding twenty five per cent or more of the capital, provided that such are known to the company. Mention must also be made of the holdings of ten per cent or more held directly or indirectly in the company by other corporate or natural persons, whenever such are general knowledge. Under Chapter 6 of the Schedule, the names, addresses, function in the company, principle activities performed outside the company, including directorships and functions performed in relation to other companies, of the new members of the administration, the director and supervisory organs of the company, as well as the other persons who assume the management of the company at the highest level and the founders and promoters of the company if it has been formed in the last five years, must all be disclosed. Furthermore the interests of the directors in the company as well as management remuneration over the last financial year must also be included in the prospectus. Options granted to all members of the management and supervisory organs as well as the staff must be stated, as must information relating to loans and profit sharing schemes. The nature and extent of the direct or indirect interests of the directors and managers and the persons they may represent in transactions which are unusual in their character or condition, effected with the company over the previous financial year and during the current year must be specified. Similar information is required under Schedule B with regard to the issue of debentures. Whilst the disclosure provisions related to the public issue of securities are an important factor in the regulation of insiders trading in the securities involved in the issue, they are by no means an effective protection where insiders are determined to abuse their position. A good example is the rights issue by the National Group of Unit Trusts Ltd., engineered by Sir Denys Lowson, and which will be

referred to elsewhere.[761] Where insiders are prepared to make profits by trading upon the basis of inside information they are likely to ignore the related disclosure obligations, even though this compounds their wrongs. Of course where insider trading is not itself unlawful the failure to conform with the disclosure obligations is of great importance, and provides a means of legal enforcement.

Apart from the disclosure obligations at the time of issue there are certain substantive provisions that should be mentioned. It is provided under Section 50 that where a general prospectus has been issued applications cannot be converted into binding contracts until the beginning of the third day after the issue of such or such further time as may be stated in the prospectus. Thus there is a minimum of three days between the issue of the prospectus and the opening of the subscription lists, which enables potential investors to obtain the information and appraise it, with professional assistance. There has been controversy as to whether a period of three days is sufficient to reduce the advantages that insiders and those privy to the issue have by reason of their advance knowledge and information.[762] Under Section 50 subsections 5 and 6, applications for allotment are not revocable until the expiration of three working days after the opening of the subscription lists.[763] The object of this provision was to curtail the practice of stagging.[764] Although stagging, similarly to insider trading, is not illegal as such, it is regarded as objectionable,[765] and is often related to activities that are expressly unlawful.[766]

Where the issue is over subscribed it is for the directors to determine the allocation and allotment of the shares. The method of deciding this is wholly in the discretion of the Board or Allotment Committee. There is of course room for abuse, but abuse is unlikely given the degree of publicity and the disclosure of allotments.[767] Furthermore paragraph 3 of the Stock Exchanges Listing Agreement requires that a company must notify the press the basis of allotment of the securities in the prospectus and other offers, and in the case of excessive offers such

notice is to appear not later than the morning of the business day next after the allotment letters or other relevant documents of title are posted. Paragraph 10 of Chapter 1 of the Stock Exchanges Admission of Securities to Listing provides that preferential treatment on allotment must be approved by the Stock Exchange in advance of the publication of the prospectus and must normally be limited to ten per cent of the amount of securities offered and then only to shareholders or existing and past employees.

(E) CORPORATE DISCLOSURE - THE RELEVANCE

Disclosure is of course a vital aspect to the extra-legal regulation of business life. Justice Frankfurter writing in Fortune nearly half a century ago[768] remarked that 'the existence of bonuses, of excessive commissions and salaries of preferential lists and the like may all be open secrets among the knowing, but the knowing are few. There is a shrinking quality to such transactions, to force knowledge of them into the open is largely to restrain their happening. Many practices safely pursued in private lose their justification in public. Thus social standards newly defined gradually establish themselves as new business habits'. Whilst directors and corporate insiders naturally do not like this aspect of disclosure, and the social restraints that it places upon them,[769] there are few who would try and justify the removal of such provisions.[770]

In recent years company managements have become increasingly aware of the importance of fostering good relations with the providers of capital, the labour force, the suppliers and the consumers. It is today accepted that the comment of Mr. A.W. Tuke the Chairman of Barclays Bank that 'we do not want the public to discuss our affairs, we would much rather they did not. The more information that we give them the more they will want to discuss our affairs and that is what we do not want',[771] is a luxury that few can afford. Certainly the financial press is astute to detect 'undue reticence'[772] and organisations such as Social Audit have 'badgered' companies tardy in this respect. Indeed, even the Stock Exchange acknowledges financial advertising as an important channel of communications.[773]

James Derriman in his excellent book,[774] emphasises that corporations must accept the impact of good investor and financial relations if for no other reason than the fear of a takeover, and a 'sell out' by the existing members.[775] Certainly the regard that managements pay to shareholders during a takeover bid is normally far in excess of that generally paid. Derriman points out that because of the complexity of financial information and the

possible lack of expertise in companies in the field of public relations, companies have misguidedly neglected this important aspect to disclosure rather than place themselves in the hands of outside experts. Another point that should be born in mind is that the disclosure here, is more than the mere supplying of information, and emphasis is placed on the establishment and furthering of relationships. Thus it is part of financial relations, that the disclosures made should be tailored to the particular needs of those with whom the relationship is intended to be built.

Derriman also points out that there is in relation to shareholders a negative as well as a positive responsibility in the provision of information. The company should disclose both good and bad information.(776) Of course it is obviously in accordance with the fostering of good public relations to disclose good information, but it is hard to pursuade business men that it is in their own and the company's interest to disclose bad information. In the long term if the position gets worse everyone will know anyway, and if things improve, premature disclosure could harm the corporations recovery prospects. The point of difficulty is where the commercial considerations should give way to the interest in full disclosure. Indeed it is possible to argue convincingly that disclosure of bad news may not be in the interests of the shareholders as a whole. Suffice it here to point to the great confusion of conflicting interests.

(F) DISCLOSURE AS A SANCTION

Whilst no attempt has been made in discussing the British disclosure system with reference to the regulation of insider trading, to point out the various aspects to disclosure enumerated at the outset to this Section, it is respectfully submitted that disclosure devices aimed at the mere provision of information, or to the assisting in enforcement of a specific norm are quite obvious. What the above discussion has not thrown too much light upon is that aspect of disclosure which utilises the effect of disclosure as a sanction. It is this third aspect which will be discussed here.

Because of the widespread dissatisfaction with the traditional criminal penalties in the case of corporate violations of the law,[777] attention has been focussed on the development of a new type of sanction.[778] Given the importance of corporate image, which has already been alluded to,[779] attention has been given to the use of disclosure as a sanction for criminal violations of the law by corporate bodies.[780] Of course the notion of public disgrace as a sanction and as a deterrent has a history dating back to the beginnings of civilization. Certain punishments were specifically directed at this goal, the 'stocks' and 'pillary' are two obvious examples.[781] The trial process and the stigma of conviction are also weighty sanctions in themselves.[782] There are also a number of recent examples of Magistrates being given the power to publicise the names of offenders, generally in the field of social regulatory offences, particularly in the context of adulteration of food and drink offences.[783] Disclosure of conduct can also be utilised as a sanction where there has been no violation of a legal norm, but some other kind of norm, an obvious example here is the use that the City Panel on Takeovers and Mergers has made of publicity.[784]

Perhaps one of the most difficult aspects of the use of disclosure as a sanction is the quantification of the effect and result that such may have in any particular case. Obviously in certain cases adverse publicity could result in pecuniary loss, and this would more likely be the case

where the disclosure cast aspersions on the product of a person or corporation.[785] It is also possible that disclosure would have an adverse effect on the price of the company's securities. It should be noted that in both these cases, at least where companies are involved the effect of the sanction is to penalise the company as a whole, and those responsible for the violation would probably be unaffected. Certainly disclosure can result in pressure being brought to bear on those responsible for the violation, possibly by the shareholders, or indeed the Government. Fisse writing in the Melbourne University Law Review,[786] considers that the main advantage of formalized disclosure as a sanction is the effect that such has on deterrence and therefore prevention. If the only effect of such a sanction was to cause some kind of economic loss, indirectly it would be preferable to impose a loss directly and clinically through the imposition of a fine. The wider aspect of disclosure is that it hits company's and most individuals greatest asset, namely their self-respect and prestige. Whilst prestige, at least in capitalistic societies, is tied up with material wealth, and the ability to produce wealth, the two are not and hopefully never will be entirely synonimous. Thus in the case of Sir Denys Lowson, whilst the widespread almost vulgar disclosures of his abusive conduct hardly scratched his estimated £200,000,000 wealth,[787] his prestige was shattered.[788] Of course it is true that where there is a criminal conviction or determination of liability automatically, at least in those systems that operate 'open justice' there is an important disclosure impact on the convicted person. Here this factor will be additional to the legal penalty prescribed by the tribunal concerned. It is debateable whether a formalised disclosure sanction, as for example suggested by Fisse in his writings,[789] is either necessary or desirable in these circumstances. Certainly in the case of a determination of a tribunal which does not have the authority to require financial or legal penalties or in the case of a disclosure of a warning or suspected state of affairs before any formalised determination then it would seem that disclosure is the most effective extra-legal sanction.

It has been said that 'this power of publicity is of particular importance in the area of....white collar offenders rather than by underprivileged people and members of devient sub-cultures',(790) Surely this is to identify wealth and prestige too closely. It would seem fallacious to maintain that a sense of social responsibility and social self respect is any lesser in the proletariate than it is elsewhere. Whilst it is misconceived to apply external moral ethics to any particular society, particularly in retrospect, it is a fact that where a society becomes divided into classes the first grouping in the hierarchy almost inevitably assumes for itself rights and privileges, hardly reflective of a social responsibility or conscience. Where the dominance of the 'aristocracy' is not by force or a resented force the surprising factor is the extreme benevolence that the 'under-classes' view the 'misdeeds' of their social superiors. Indeed there is considerable empirical evidence that social pressure and disclosure as a social sanction is all the more effective in egalitarian societies, contrary to Fisse's remark.(791) It is perhaps true that the effects of adverse disclosures in the case of a corporate official or 'white-collar' employee might be more visible but it is very much open to question whether there is any more real damage than in the case of a 'blue-collar worker' or someone lower on the social scale. The distinction would seem to be in the type of crimes that the two sections of the community commit. It would be a reasonable assumption that more 'fraud offences' are committed by so called 'white collar' employees that 'blue collar', but this is due to the first category having a much greater opportunity to commit this type of offence. The ordinary factory worker is hardly going to have the opportunity and ability to pledge securities without authority, falsify accounts or probably indulge in insider trading. Whether such 'offences' should be treated any differently to the more general crimes of theft, rape and assault is a question for the penologists.(792)

There is probably weight in Fisse's comment that disclosure is not too relevant in the context of 'devient subcultures', but this is because 'devients' are by definition not a party to the social mores and ethics of their culture,

unlike the underprivileged who will be whether by force or acceptance.. Furthermore there is a need to qualify exactly what is meant by devients in this context.[793]

As has been pointed out above perhaps the most significant utilisation of disclosure as a sanction or social regulatory device is in the case of transgressions of non-legal norms. This is of course of great interest from the stand point of the regulation of insider trading in Britain. In this context there is the additional aspect of disclosure acting as an educational or moralising factor. Whilst legal norms can be used to this end[794] by virtue of their dependence on formalised enforcement and forensic determination, and also the fact that legal norms generally must represent the minima of moral value in that context, the educational potential for disclosure in the case of non-legal rules is that much greater.

Thus disclosure in the present context has a number of significant aspects, Fisse comments that it can be used 'for the possible primary purpose of lowering prestige, inducing monetary loss,' inducing government intervention and for the possible supplementary purposes of warning, moralising and nofifying prospective criminals of penalties imposed upon convicted criminals'.[795] Of course it is the multiplicity of influences that a disclosure can create, which makes it a perilous tool in the hands of a regulator. At the London Conference on Insider Trading in the Spring of 1975, the then Chairman of the American Securities Exchange Commission stated that the Commission were for this very reason reluctant to publicise cases and investigations that were not brought before the Courts where there was a proper system of appeals.[796] This approach was all the more important where professionals engaged in the securities industry were involved, as the effect of a disclosure could unjustifiable be ruinous. The Commission were also concerned about exposing a person to overwhelming civil litigation, by their disclosures.[797]

Where disclosure is consciously intended to have a sanction effect, there are a number of problems that should at least be indicated here. Firstly it may be difficult to pursuade the relevant recipients of the disclosure that the object of the information deserves losing a certain amount

of prestige. It is important to realise that in most cases it will not be necessary to make a general disclosure and it will be sufficient to give the information to a particular agency or body.(798) The problem of obtaining the desired reaction is all the more difficult where the publishing agency is operating from outside the group that the intended recipients are in. Thus the membership of a particular professional body as a general proposition will be more inclined to accept the indictment of one of their numbers by their own disciplinary body than they would that of a Magistrate or civil servant. This is particularly the case where a specialised type of activity is involved, the full implications of which might reasonably not be fully appreciated by an outsider.(799) An interesting case illustrating this is that of R. v Greenstein and Green, to which reference has already been made. The defendants who had indulged in 'stagging' and who had submitted cheques without sufficient funds, contended that their acts were not dishonest and that what they had done was widely practised in financial circles. The same point was made by Mr Brian Neill Q.C. for the defence, and also the Times. The Midland Bank Manager for the Ilford branch had actively assisted them and had not considered the operation illegal or objectionable.(800) On the otherhand Judge Alan King-Hamilton Q.C. thought the operation was 'a gross abuse of the banking system' and 'dispicable', and his decision was unanimously affirmed on appeal. Whilst the actual conviction was based on 'obtaining property by deception', the Head of the Frauds and Bankruptcy Section of the Director of Public Prosecutions considered that it was the 'stagging' that was the 'true crime' and although the underlying law on this had existed some considerable time 'it had to be adapted so as to create a special offence'.(801) It is seriously open to question whether the general opinion in the City would consider that stagging should be regarded as a criminal offence involving reasonably long terms of imprisonment. This is not to say that there would be much public sympathy for Mr Green and his brother-in-law.

The problems are even greater where the object of the adverse publicity is a person with some prestige and a prior good reputation. Where the object of the disclosure

is a person of power, who does not have to rely in any way upon the persons to whom the disclosure is made, the sanction can be of dubious worth. Where the object of the adverse disclosure is a corporate person or institution there are psychological problems and difficulties of identification and responsibility stemming from the complex nature of corporate personality and image.(802) The persons to whom the disclosures are made may not of course be willing or able to adopt any approach or retaliatory action against the object of the disclosure. Apart from the possibility of sympathy the recipients might have business or social connections with the object of the disclosure, that in self interest he is not prepared to sacrifice,(803) or indeed of which he is under a duty to others not to imperil.

Another difficulty is that of phrasing the disclosure so that it has the desired effect. Whilst advertising techniques are of some relevance, there is a great difference in the nature of the disclosures. For example a good advertisement should make it abundantly clear what it is desired for the recipient to do, obviously in the present context this would be impractical and probably undesirable. Fisse considers that it would be wrong to merely publish the facts of the case, as where such are complex as they almost inevitably would be in commercial cases, the intended recipients would either not take the trouble to read the presentation, and if they did, they most likely would not understand it. Whilst the present author appreciates the danger here, in the majority of cases, certainly those involving simple cases of fraud or insider trading it would seem sufficient to merely set out the essential facts, and either expressly declare what is wrong with the conduct in question or provide a sufficiently recognizable indication of such. This is the course adopted for example by the City Panel on Takeovers and Mergers. In such cases the inference to be drawn from the facts is quite obvious, and a matter for the individual recipient. Where the facts are particularly confusing or of a technical nature an appropriate, yet fair explanation can be given. Likewise where the conduct disclosed is not patently of an objectionable nature, and thus the disclosing agency is

primarily concerned with educating the recipients a sufficient explanation should be provided.

Another problem of some importance is where the object of the disclosure or those in sympathy with him attempt to harness the publicity machine against the adverse publicity directed against them, or indeed against the disclosing agency. There have been numerous cases where this has occurred.[804] The person attacked has certain significant advantages over the court or Tribunal responsible for the original disclosure. He will not be circumscribed by the costs or methods he can employ, and there is no obligation on him to explain technicalities or indeed make a fair presentation. Furthermore the person concerned can fasten upon what aspects of the case would seem to afford him the greatest opportunity of obtaining sympathy and support. Indeed there is nothing to prevent quite irrelevant counter allegations being raised so as to cloud the issue and attract support. One cannot either rule out complete fabrication. Obviously it would be unlikely that a Court or Tribunal or indeed any official body could effectively engage in a campaign to vindicate itself in the face of such tactics. The cost alone would be prohibitive. It might be urged that there should be statutory provisions that the subject of such a disclosure should not engage in counter publicity, but apart from the profound definitional and enforcement problems, this would probably be objectionable on constitutional and civil liberties grounds.

Associated with the multiplicity of aspects that disclosure as a sanction can have, and which has already been discussed there is the fact that the disclosure sanction is unpredictable in its results and could have unlimited repercussions. It is a fundamental principle that in the absence of overwhelming other considerations of a public nature a man should not be subjected to punishments unreasonably in excess of his wrong doing. There is a point where the punishment can itself become unjust and thus self-defeating. Obviously the effect of disclosure will vary with the nature of the information, the character of recipients and the time and place that the event occurs. Unlike other criminal punishments the disclosure sanction is inevitably 'part and parcel' of the social environment

of its point in time. What would be wholly unacceptable for a trade union official to do, might be merely shrugged off if done by a slick City financier.

Rourke writing sometime ago in the University of Chicago Law Review, commented[805] pointed out that from the stand point of deterrence it was of importance that others could see the extent of misfortune that had befallen the recipient of the punishment. With disclosure because of its uncertainty and essentially indirect repercussions the true extent of the penalty would not be appreciated by outsiders, who might indeed consider that the person concerned has escaped very lightly. This has certainly been the case with the Takeover Panels.use of disclosure and also that of the American Securities Exchange Commission.[806]

It is also extremely difficult to predict in advance how the media will treat a particular disclosure. If there is a large volume of important current news the media may only devote scant attention to a serious abuse whereas when news is scarce considerable attention to a relatively minor case. Furthermore the press will be concerned to concentrate more on the emotive and sensational disclosures. There is also the danger of bias in the media and unfairness of presentation and comment.[807] Moreover, it is important that the object of the disclosure should not be allowed to present his case before the disclosing agency presents its release, as it is always more difficult to attack by refutation in this context.[808]

Whilst it is true that because of the problems alluded to, and also no doubt a degree of ignorance, there are few instances throughout the world where disclosure is formally used as a sanction.[809] This is not to say that it is of little significance from the point of view of this thesis, as it has certainly been utilised in cases of insider trading. In Britain the regulation of insider trading, by the press, the Take-over Panel and in the recent year or so through Department of Trade Inspections has operated almost solely upon the basis of disclosure as a sanction. Whether this has been adequate or not is to be doubted, but the importance of the topic remains. It should be noted that the Courts on a number of occasions have alluded to the punative effect of disclosure, particularly with regard to loss of reputation.[810]

(G) DISCLOSURE OF INFORMATION TO EMPLOYEES AND THE QUESTION OF EMPLOYEE PARTICIPATION

(a) DISCLOSURE OF INFORMATION TO EMPLOYEES, UNIONS AND GOVERNMENT DEPARTMENTS

Company law has paid scant attention to the 'rights' of employees and the position of such in the corporate structure.(811) So far as disclosure of information is concerned, the traditional stewardship approach,(812) has not provided the type of information that employees require, and there has been a serious breakdown in the flow of information about the affairs of the corporation in this respect.(813) Furthermore 'according to an old saying 'knowledge is power' and excessive publicity could result in a shifting of the balance of power which the law seeks to maintain so that the relationship between management..and...owners is changed.(814)

Given this last factor that information can effect the power structure, the question of employee disclosure and obviously that of employee participation in management is politically highly charged. Because of the nature of this topic and the uncertain state of the future law, it is to be hoped that the rather disjointed discussion that follows will be excused, at least with regard to its presentation.

Whilst the Industrial Relations Act of 1971 has been repealed by the Trades Union and Labour Relations Act 1974,(815) it is worth briefly mentioning the disclosure provisions which it enacted, but which were never implemented.(816) Under Section 56(1) it was provided that an employer was under an obligation to disclose to the representatives of registered trade unions 'all such information relating to the undertaking as is in the possession of the employer or an associated employer' and is information without which the trade union representative would be 'to a material extent impeded in carrying on collective bargaining with him', and that it would be in accordance with good industrial relations practice for the employer to disclose such information for the purpose of collective bargaining with him. This was subject to the restrictions of Section 158, which excused the employer from the disclosure obligation in certain circumstances. These included inter alia where disclosure

would be against the national interest, a legal requirement or confidence, or the disclosure would be prejudicial to the interests of the employers undertaking for reasons other than those connected with collective bargaining.(817) In addition Section 56 provided that the employer need not supply the information where its compilation and provision would involve such time and trouble so as to be out of reasonable proportion with its use for the purposes of collective bargaining. There were provisions for the union representative to appeal against such an assertion by the employer to the National Industrial Relations Court, under Section 102. The Code of Industrial Relations Practice, in its provisional form asserted that meaningful negotiations could only be conducted upon the basis of adequate information, and to this extent the employers were commended to supply all information reasonably relevant to the negotiations that they may be engaged upon, and to supply all information that is given to shareholders to the union representatives. It was specifically stated however that 'management is not obliged to disclose certain kinds of information, including information which would be of advantage to a competitor'.(818)

When the Commission on Industrial Relations came to report on disclosure, because of the multiplicity of different factual settings, it only recommended broad lines of disclosure, suggesting that companies and unions should reach agreement on the more specific aspects. Nevertheless the Commission did indicate certain guidelines for the sort of information that they considered should fall within the ambit of proper disclosure. These guidelines are mainly concerned with information orientated to employment and pay and thus do not concern this present study. However the Commission did state that the information made available to members and to the public at the Companies Registration Office should also be supplied to union representatives, furthermore long and short term labour prospects should also be disclosed. The Commission also thought that investment and merger plans should be made available. No doubt certain of this information would have been price sensative and of a non public nature. Of course

exactly how the provisions and guidelines would have worked in practice is an open question. Certainly the provisions directed at enforcement were weak, and the rights to information were restricted to registered trade unions.(819)

The Trades Union Congress on a number of occasions has underlined the significance of proper disclosure to the operation of a viable collective bargaining machinery,(820) and its recommendations on disclosure found favour with the Labour Government which came into Office in 1974. The Government sought to replace the almost universally criticised Industrial Relations Act by a four pronged approach. This was the enactment of a Trade Union and Labour Relations Bill, an Employment Protection Bill, an Industry Bill and an Industrial Democracy Bill. As at the time of writing only part of this programme has been completed, it is difficult to estimate the eventual impact of this approach. The Employment Protection Act 1975 is a complex statute, but relatively uncontroversial.(821) Concentrating purely upon disclosure the Act places an obligation on the Advisory, Conciliation and Arbitration Service, (ACAS)(822) to 'encourage extension of collective bargaining machinery' which of course includes that of disclosure. It would seem that under this provision a trade union could require recognition on the question of financial planning by a company and associated companies, and thus the disclosure would go far beyond that normally associated with labour questions.(823) Under the terms of the Act,(824) there is an obligation on employers to disclose to the unions in writing information covering all items of collective bargaining for which the union is recognised and under the wording of the relevant provision it would appear that the union could seek recognition on almost anything. The only restriction is that the information should be such as would be 'good industrial relations practice to provide' and would if not provided materially impede the unions effort in collective bargaining. This provision although slightly wider than the old Section 56(1) has much in common with it. In section 18 of the Act the qualifications on the rights to disclosure formerly found in Section 158 are reproduced

with slight modification. There is an appeal in the event of a refusal to disclose to the ACAS, which as has been seen is charged with facilitating disclosure to trade unions, and then there is an appeal to the Central Arbitration Committee. Exactly what information will be within the scope of these sections awaits the finalisation of the ACAS's Code of Practice. It would seem likely that it will go beyond the recommendations of the Commission on Industrial Relations report on 'the Disclosure of Information' in 1972. However it should be remembered that this Act is only concerned with disclosure in the context of collective bargaining, and although thus having a greater width of application it is by no means as far reaching as the information that will have to be made available under the Industry Bill and the proposed worker democracy legislation.

A much more radical and far more controversial approach is that found in the Industry Act of 1975.[825] In August 1974 the Labour Government published a White Paper entitled the Regeneration of British Industry,[826] the aim of which was to lay out the Governments views on how to accommodate the variety of interests now acknowledged to exist in British Industry. The essential feature of the proposals was to forge a partnership relationship between the Government and industry. The instruments of this new relationship are the National Enterprise Board and Planning Agreements. A fundamental facit would be the much freer exchange of information between the relevant Departments of State and private industry.[827] Although it is not possible to enter into a discussion of the nature and role of the N.E.B. it should be pointed out that it will assume the ownership of all present and future Government Shareholdings and facilitate developments by taking equity positions. The possibilities for abuse and insider trading are obvious,[828] both in the context of the Government and also members of the administration. Whilst the N.E.B. will naturally have considerable access to price sensative information the Department of Trade in a Consultative Paper emphasised that the NEB would not be involved in the negotiation of planning agreements and would not be given 'inside information' by Government Departments.[829]

Of primary interest from the stand point of this thesis

is the 'planning agreements' which whilst not being contracts as such, through statutory provision will have a number of legal aspects, such as will enable both the Government and company to rely upon such. The Bill contemplates that there will be consultation between the Government and companies, leading to an agreement about plans for the future three years. In an attempt to harmonise and advance the Governments and industries policies and aspirations the Government will have funds available to assist the plans.(830) The planning agreements are primarily intended to involve 'major and strategic firms in key sectors of the manufacturing industry and selected other industries of particular importance to the economy'.(831) It was also stated in the White Paper that employees and their representatives should be consulted in the procedure leading up to the agreement, and that for this consultation to be effective it would be necessary to supply the employees and their representatives with the appropriate amount of information. The Government stated that it would require employers to disclose information relevant to the planning agreement except where such would be contrary to the interests of national security.(832)

The result of these proposals was the Industry Bill, which introduces a number of significant changes into British company law.(833) Attention will here be given to only those aspects relevant to disclosure and insider trading. The Bills provisions with regard to the disclosure of information are considerably more controversial than the proposals in the White Paper in that the basically voluntary approach is abandoned. Clause 20 provided that if it appears to the Minister that any person is carrying on in the United Kingdom a manufacturing undertaking that makes a significant contribution to a sector of an industry which is important to the national economy or any substantial part of the economy or industry he could order that such a company or his subsidiary is to be subject to the disclosure provisions of the Act. This order would however be subject to annulment by resolution of either the House of Commons or House of Lords. Under Clause 21 it was

provided that for the purpose of obtaining information which is in the Ministers opinion necessary for the appreciation of the future plans of a company to whom an order has been made under Clause 20, the Minister may by notice require that the company or its subsidiaries furnish him in such manner and in such reasonable time as is specified in the notice, with such information relating to the undertaking in the United Kingdom as the Minister may require. The type of information that would be comprehended within this power was detailed in Clause 21(2), and inter alia included future merger and aquisition plans, and other categories of information that could be of a price sensative nature. Moreover under subclause (4) the Minister could require the provision of information with regard to estimates as to the state of facts that will obtain at a future specified date. These Clauses did not engender over much criticism, but great objection was taken to Clause 22.

This Clause provided that 'not later than at the end of a reasonable period after a minister has received the information specified in a notice under Clause 21 it shall be his duty ...to serve on the person furnishing the information a further notice requiring that person ...to furnish to a representative of each of the relevant trade unions[834] within such reasonable time as may be specified in the notice the information required to have been furnished to the Minister. 'It was however, stated in Sub clause (2) that a Minister will not require such disclosure if he considers that to furnish such would be undesirable in the national interest or that the information could not be furnished without contravening a statute. Under this provision when the Minister serves the initial notice on the person concerned that person must furnish immediately to the representatives of each of the relevant trade unions a notification that the employer has been served with such a notice, and the employer must send to the Minister a list of those representatives on whom he served this notice. It is also provided that before the Minister determines whether the information should be made available to the unions he must give the employer and the union representatives an opportunity to make representations

to him. Under the terms of Clause 23 a person upon whom a disclosure notice has been served could appeal to an 'appropriate Committee' within a period of twenty eight days. This Committee was empowered under the Bill to direct that the person concerned should be released from the duty of disclosure, if they were satisfied that the information had been communicated to that person in confidence, or that the disclosure would seriously prejudice the interests of the undertaking. Where the employer made an application to the Committee he would have been under an obligation to give the union representatives notice of this and of the Committee's decision.

It should be noted that the Bill made no mention of 'planning agreement' disclosure, and such agreements were only referred to in Clause 14 in the context of financial assistance. The Government played this aspect of the new approach on 'a very low key',(835) although it was emphasised that trade unions could negotiate agreements individually with corporate employers for additional disclosure.(836)

Of particular interest is the provisions in the Bill on confidentiality. Clause 24 provides that information shall not be disclosed without the consent of the person furnishing it except to a government department for the purposes of the exercise by that department of any of its functions, to the appeal committee set up by the minister for the purpose of hearing and determining appeals under the disclosure provisions, the Manpower Services Commission and various other Government labour agencies, and in connection with the investigation of a suspected offence under the Act.(837) This provision applied to information that had been supplied to the Minister in consequence of a notice served under the terms of Clause 21, which has not been at that time supplied to a trade union under Clause 22. Thus the information under these provisions ceases to be of a confidential nature at the point in time when it is supplied to the trade unions, although it might arguably remain confidential and within the restrictions of Clause 24 as regards the Minister. It was provided under Clause 26(3) that in the case of a

violation of the confidentiality provisions on summary conviction there is a fine of £200 and or a term of imprisonment not in excess of three months, and in the case of a conviction on indictment two years imprisonment and an unspecified fine. In the case of other violations of the other provisions of the Act the Clause provided for a fine of £400 and a default fine of £40. Among these other offences was the knowingly or recklessly furnishing a false statement. In all cases it was provided in the Bill that any proceedings can only be brought with the consent of the Attorney General.

Under Clause 24(3) it was provided that the preservation of confidentiality, 'does not apply to any information at a time after a person has been convicted of an offence under Clause 26(1)a' which deals with the failure to furnish information to the Minister, but not the making of a false statement which is prescribed under Clause 26(1)b. Peter Wilsher writing in the Sunday Times states that 'this as far as I can see removes the last rag of confidentiality from anyone who has been convicted of refusing to give information...the Minister and his officials are free once such a conviction has been recorded to publish to the world...any data they have previously culled from the unfortunate firm involved'.(838

Whilst numerous industrialists had already accepted the need for greater disclosure of information to their employees,(839) and employees had themselves become aware of the importance of this matter,(840) there was considerable opposition to the Industry Bill.(841) Among the more rational attacks on the Bill was that of the City Capital Markets Committee, which issued a memorandum on the Industry Bill. The Committee were concerned at the breadth of the disclosure provisions and thought that a lot of information that could be required under Clause 21 (2) was of a 'confidential and price sensative nature'. Apart from the danger of unfair competition, the Committee were anxious that disclosure of certain types of information, the value of which lay in their confidentiality, would result in misappropriation or at least destruction of a corporate asset without compensation. Given the 'legions of civil servants' involved in the progress the Committee was

sceptical as to the Governments promise that the information would remain confidential.(842) Indeed the Committee were concerned about the improper utilisation of price sensative information by persons both inside and outside the Government. There was a need for a provision analagous to Clause 13 of the Companies Bill 1973, which will be discussed elsewhere. The Committee and also the Stock Exchange(843) were concerned that the disclosure of price sensative information to trade unionists would in effect make such recipients 'insiders'. Furthermore given the fiduciary position of directors, it was contended that under both the law and the Stock Exchange Listing Agreement, there would be an obligation on the directors to disclose information of a material nature to the shareholders at least simultaneously to the provision of it to the trade unions. The Stock Exchange had sponsored an amendment to Clause 24, which would have required the information disclosed to union representatives to be likewise, and at the sametime, under statute to be disclosed to the shareholders. The Stock Exchange thought whilst being of benefit to investors, such an obligation would remove the 'insider responsibilities' from trade union representatives.(844) The Government rejected this proposed amendment. With respect it is submitted that the Stock Exchanges argument was valid, and the present author has taken the liberty to submit similar evidence to the Committee on Industrial Relations on this point. In a letter to the author, from the Director of Corporate Liaison at the New York Stock Exchange, it is stated that 'the New York Stock Exchange has always taken the position that material disclosures of significant business developments be broadly disseminated so that shareholders and prospective investors can assess the merits or demerits of investment on the basis of all the facts relating to a company's business'. It followed that as a matter of practice the Exchange would impose a trading suspension if material information had been disclosed to various groups, as for instance trade unionists, in the absence of general disclosure.(845) In the words of the Director, it would be of critical importance that the disclosure to trade unionists and shareholders was simultaneous '...so that investors and

employees, who may also be investors...would be on an equal plain'. The Director of the Office of Public Information of the Securities Exchange Commission,(846) and the Director of Information of the National Labour Relations Board,(847) confirmed that the New York Stock Exchanges approach was the correct one under both American law and practice. Another problem pointed out by the City Capital Markets Committee, and the Stock Exchange is that in certain cases there may be some twenty or so independent trade unions to which disclosure may have to be made, and even then there will be workers who as they are not members of a trade union will not have the advantages of this disclosure.(848)

The Government whilst maintaining that the disclosure provisions would only be utilised in the case of companies where there was already a planning agreement voluntarily entered into, or where the Government had been asked to take a financial interest in, on a number of occasions intimated that the provision of information would effect the traditional control of the corporations concerned.(849) Apart from this there is the fundamental point succinctly stated by Peter Wilsher in the Sunday Times, 'civil servants and Ministers are bound by the Official Secrets Acts...and by a set of specific if slightly ramshackle safeguards in the Bill itself...' but with regard to disclosure to trade union representatives 'there appear to be no safeguards whatever...there are no sanctions to prevent such a representative who may of course have no connection other than his union position with the company, from passing on the information to a competitor, foreign Government, extremist political fraction or come to that his own stock broker in the form of a large personal order'.(850) The problems of conflict of interest are acute. In a large number of cases the information might refer to the provider of the informations dealings with another company, the employees of which perhaps being members of the same trade union as that of the representative to whom the disclosure was made. Although the union official was given the information in relation to the provider of the information, where that disclosure bears upon the interests of fellow trade unionists in that other

enterprise can he pass it on or act upon it in protection of those other employees. The problems are obvious in a takeover situation, or perhaps generally in a competitive environment. From the wording of the provisions and the observations in Parliament it would seem that the intention is that the union official is to have a complete discretion to use the information as he will, once it has been disclosed to him. Whilst there has been little evidence in other European countries that worker directors and representatives have utilised confidential information improperly, it has to be noted that trade unions are significantly stronger in the United Kingdom and are of themselves a powerful political force. Disclosure under the mandatory disclosure provisions is not to employee representatives as such which might be expected to have the immediate interests of the particular workforce and thus the enterprise at heart, as well as feeling a degree of loyalty to the company, but to representatives of the relevant trade unions which are, or at least have allegiances to an essentially outsider body. Both the Conservative and Liberal spokesmen advocated disclosure only to some intra-corporate representative body.(851)

It is not without interest that the Confederation of British Industry, before the controversy really developed, sent its members guidelines on the handling and disclosure of internal information. In the self-interest of member corporations the Confederation recommended that 'company information policy groups' should be formed, which would be responsible for the internal flow of information. The guidelines recommended that all information that was relevant to employees desires and wishes, subject to considerations of competition should be disclosed, although this should not facilitate the premature leakages of confidential price sensative information.(852) The Council of the C.B.I. strongly urged members not to give privileged information to selected groups or representatives, in the absence of a general disclosure, even if such persons agreed to observe confidentiality.(853)

Because of the pressure brought to bear on the Government a more concillatory approach was promised, the Paymaster General, Mr. Dell M.P. stated that provided

greater employee disclosure was accepted, the Government would take a fresh look at the arguments relating to confidentiality and insider trading.(854) In the result after significant and somewhat trenchant battles in both Houses the disclosure provisions in the Bill were modified. By virtue of Section 28 of the Industry Act, 'for the purposes of obtaining information which in the opinion of either of the Ministers is needed to form or to further national economic policies, or needed for consultations between Government, employers or workers on the outlook for a particular sector of the manufacturing industry, including the outlook for the major companies in that sector, 'may serve a preliminary notice on the company or companies concerned, provided that the company is carrying on in the United Kingdom an undertaking wholly or mainly engaged in manufacturing, that the undertaking makes a significant contribution to a sector of such industry important to the national economy or a substantial part thereof, and that it is desirable for the purposes of obtaining information of that description that the companies or company concerned should provide the Government and a representative of each relevant trade union with any such information relating to the undertaking. Under subsection three the Minister must lay before each House of Parliament that he has issued such a notice, and it can be annulled under subsection (8) by a resolution of either House. The preliminary notice must inform the company that unless the relevant information is given to the Minister and a representative of each relevant trade union voluntarily he will consider making an order under Section 28. The Section also has provisions for the notification of the trade unions and the sending of a list of such to the Minister as was provided in the Bill. After a period of three months has elapsed from the serving of the preliminary notice the Minister can declare that the disclosure provisions apply to the company or companies in question. However the Minister can only make such an order if it appears that the company will not voluntarily provide him and the unions with the information. As under the Bill there are provisions affording rights to be heard by the company and the authorised representatives of the unions before the making

of the order. Section 30 which details the categories of information within the scope of Section 28, largely reproduces Clause 21 of the Bill. Nevertheless, there is an amendment of extreme importance, contained in subsection (5), which provides that 'nothing in this section shall be construed as enabling a Minister to require information about the details of know how or of any research or development programme'.(855)

The provisions in Clause 22 requiring disclosure to trade union representatives were enacted in Section 31, but again with some significant amendment. It is provided that the Minister 'shall not require information to be furnished if he considers that reasons of national policy or special reasons apply. 'Reasons of national policy are defined to include where it would be inimical to the national interest or in contravention of an enactment. This largely reproduces the exception contained in Clause 22(2). In addition however, is the category of 'special reasons'. This comprehends information obtained in consequence of a confidence, where disclosure would cause substantial injury to the company, or to a number of employees. The appellate procedure laid down in Clause 23 is enacted with slight modifications in Section 32. The important thing to note is that the report of the Advisory Committee on whether there should be disclosure or not is only advisory, and in no way binding. The provisions relating to confidentiality and offences in Sections 33 and 34 respectively are the same as the provisions in the Bill.

Whilst the amendments, particularly those relating to the circumstances where a preliminary notice could be made, seemed to have a salutary effect on the criticisms of the Bill, except from the left wing of the Labour party, it is to be doubted whether the degree of protection of confidential information is much altered. The simple fact remains that there will be an increased number of civil servants and trade unionists in receipt of at least some 'insider information' and particularly in regard to trade unionists there is no clear delineation of the responsibilities that attach to this situation. The dangers are obvious.

(b) EMPLOYEE PARTICIPATION IN MANAGEMENT AND INSIDER TRADING

The question of employee participation is one of extreme importance, legally, politically, socially and economically. Whilst participation has an important bearing on the regulation of insider trading[856] because of the great volume of discussion and materials it is unfortunately necessary to discuss the matter only in a superficial manner here.

Employee participation is one of those misleading terms which has a variety of meanings, and standing alone without qualification only serves to confuse. It can refer to employees actively themselves participating in management, or through elected or nominated representatives, or merely being consulted on certain issues, or possibly only having certain rights to information.[857] No matter what sort of model is adopted there is inevitably a greater degree of disclosure either to the employees themselves or their representatives, involved and thus a greater risk of insider trading. Where there is direct participation in management with employee nominees on the board of directors or on a supervisory board the danger becomes acute. There is also the additional feature that the advent of increased participation in management imposes another supervisory aspect to the conduct of insiders within the corporate structure.

There is of course considerable experience and legal development on employee participation and code termination on the European Continent. Whilst a detailed discussion of the various laws, particularly in West Germany, the Netherlands and certain Scandinavian Countries would be highly beneficial from the point of view of obtaining a comparative aspect to this important area of company law, it is with regret that it has been decided, for considerations of space to omit this. What is of some interest is the apparent absence of provisions in the various European laws relating to increased employee disclosure and participation in management, of restrictions on the use of such information thereby acquired.[858] There are certain provisions in the general law imposing

liability for improper use of confidential information, in most countries. On the other hand it would seem that there has been little evidence of abuse of these rights, with regard to insider trading.

The question of employee participation in the corporate structure, and the increase in the information provided to employees generally and their representatives, has assumed great importance in the last couple of years. There has been an almost universal realisation in the United Kingdom that it is both legitimate and desirable for employees to be more meaningfully involved in their corporate employers. The point of difficulty has been as to exactly how this is to be accomplished.

One particularly troublesome question is however, what duties a director who is essentially a representative of the employees or the relevant trade union should have to the company, and non-labour interests, where the model of worker director participation is applicable. The Trades Union Congress and the Labour Party's Report, the Community and the Company,(859) consider that the 'worker directors', which both have advocated should be introduced on a mandatory basis, should have their duties and responsibilities specifically defined, and should not be under the general fiduciary duties of the ordinary directors. The T.U.C. has emphasised on a number of occasions that the information that is acquired by the union representative on a board of directors, would be useful for the purposes of collective bargaining. However it would seem that if this is going to be the norm, the law would need to be altered or at least clarified.(860) The City Company Law Committee in its report on employee participation,(861) was most critical of the suggestion that 'worker directors' should be afforded a special position with regard to their corporate duties. The Committee claimed that 'it would...be regarded as unthinkable by a continental jurist that employee members of supervisory boards should have different duties, responsibilities or liabilities from those of other members'. Whilst it was acknowledged that a trade unionist serving on a corporate board might often be confronted with conflicts of interest this should not justify a release from his duties to act bona fidi in the best interests of

the company and to observe the general duties of a director.[862] The Stock Exchange in its comments to the Labour Party's report on 'the Community and the Company' considered that it was 'unacceptable that a certain class of director should receive special legal status'.[863] The Labour Party in this report, however, stated that apart from the basic duty of advancing efficiency in the corporation, worker directors should bear certain fundamental fiduciary duties that all directors bore. The Report commented that 'such a duty implies that they must not profit from their office by the private use of inside information gained in the boardroom and must not impart to third parties confidential information'. The Working Party which wrote the report, continue that 'even their right to report back to their workers would no doubt have limits in respect of trade secrets the dissemination of which could injure the company's competitive position'. There is no mention however, of price sensative information that is not a trade secret and it is unfortunate that the Working Party did not go into this problem further.[864] The duty upon worker directors to report back information that comes into their possession, to their constituents is a matter neglected by most writers and commentators on the subject. If employees are to be properly protected and appraised of the true state of affairs of their corporate employer, it would seem that a high proportion of so called 'inside information' might under this criteria be legitimately disclosed to them. Now that it is generally accepted that employees in a company have in many respects an interest in the company as great as the majority of investors it is possible to argue that the disclosure rights of such should be at least equal to those of investors.

The recommendations of the Labour Party's Report on employee participation and the informational rights of employee representatives, read on conjunction with the recommendations made by the Working Party on insider trading regulation presents a strong possibility that worker directors would find themselves in an intolerable position with regard to the information that they acquire. The Working Party recommended in effect that all persons with price sensative information, are to be regarded as

insiders. This is qualified by the fact that an insider would under the recommended provisions only be liable if he uses the information for the purpose of dealing to make a profit or avoid a loss, or that he communicates the information to another with the intention that the recipient might engage in dealings, or where there are good reasons for supposing that he might.(865) If a worker director or representative was placed in possession of material price sensative information about the corporate employer and he considered that it was his duty to inform his constituents which might number some 40,000 employees it would be at least reasonable to assume that some of the recipients of the information might arrange any investment intentions that they might have with regard to their corporate employer, accordingly, and thus at least on a literal construction of the law, as recommended by the Report, expose the worker director to liability under the anti-insider trading provisions. There are of course a host of other examples that could be given.

The Labour Party's Working Party did deal, to some extent, with the objection that a worker director in one company might communicate information to another worker director or representative in another corporation which would injure the competitive position of the first company, either directly or through the trade union. The Report observed that 'we do not believe that the sense of responsibility of those who meet in a working mens club would fall below that of their critics who often converse after dinner in their London Clubs with directors from other companies.(866) The Report also pointed out that worker directors no less than other directors, and probably even more, would be interested in the viability of the company and its future. However, where the employee representatives are nominated or representative of a trade union then it has to be accepted that there is a natural and strong allegiance to the essentially 'outside' interests of the union and its membership.(867) In dealing with union allegiance, at the level of worker directors and regional officials the strong political element has to be considered. Indeed in Germany there have been cases where the employees have actively campaigned and voted out of office their union representatives in favour of a

representative from among themselves.(868) The employees have in such cases evidently felt a lack of sympathy between their own best interests, as they see them, and those advocated by 'worker directors' with certain 'outside' interests. It is obvious that a union nominated director has a 'duty', perhaps an overriding duty to his union and it would be fascile to think that the interests of the union and the particular company will always or even generally coincide.(869)

It is of some interest to refer to the provisions in the Industrial Democracy Bill of 1975, which was a private members bill, introduced by Mr.Giles Radice M.P., and which was drafted with the assistance of the T.U.C. The relevant provision was contained in Clause 1(2) of the Bill.(870)

> 'A director, member of a supervisory board or member of a management board shall observe the utmost good faith towards the company in any transaction with it or on its behalf and act honestly in the exercise of the powers and discharge of the duties of his office, and in particular shall not make use of any money or other property of the company or any information assigned by him (871) by virtue of his office to gain directly or indirectly an improper advantage for himself at the expense of the company'.(872)

This provision was obviously intended to cover considerably more than insider trading, and covers a large portion of the traditional fiduciary responsibilities of directors and officers. It is dubious how much further this provision would have taken the existing law. It would seem in essence merely to restate the existing law.(873) The impact of this provision on insider trading would, it is submitted have been minimal. Firstly it remains to be seen what the words 'information assigned by (probably, to) him' means. This would seem to import that information must be given rather than taken, and that there has been a conscious assignation by the corporation through its appropriate officers. This fundamental uncertainty is highly undesirable in this type of provision. Secondly in view of the unfortunate experiences of the Australian States with their similarly worded section 124(2) of the Uniform Companies Act 1961, the 'words gain directly or indirectly' would seem to refer to the gaining of the

advantage, rather than the use that the information is put to. This would seem to limit the provision to cases where the insider obtains the advantage directly himself, and not 'indirectly' through his spouse or associates. Whilst this may seem rather confusing the Australian provision was construed as to be inapplicable where the insider allows his infant children to trade, or trades on their behalf, or his spouse or his associates.(874) Because of these difficulties, and the fact that it was possible to evade Section 124(2) of the Australian provisions by interposing another corporation between the issuer of the securities and the insider, the Australian States amended their section so as to provide that the words 'directly or indirectly' appear immediately before the words 'use'. These provisions will of course be discussed more fully elsewhere.

Furthermore, and perhaps a greater deficiency, is that Clause 1(2) only prohibits an insider as defined in its scope, making a personal gain, and not allowing someone else to gain by his passing on the information or dealing on their behalf. The danger of 'tipping' and 'leaking' confidential information is likely to be a much greater danger in the context of worker participation than worker directors or representatives directly indulging in direct insider trading themselves. It would seem reasonable to assume that most trade unionists and people likely to be worker representatives would not normally have equity investments themselves. The problem is all the more acute as many persons do not appreciate the dangers of passing information of this nature on, to others, and would not necessarily consider that it was wrong. The Cohen Committee made this point.(875) The Clause only covers the situation where the insider makes a personal gain at the expense of the company. This is obviously a far too narrow approach, although rather anomalously the Jenkins Committee recommended this approach.(876) It would be exceedingly difficult in most cases of 'pure' insider trading to find any corporate detriment, of a tangible nature. Furthermore most systems of law that cover insider trading view the insiders gain or corporate detriment as alternative basis for liability, not complementary.

Furthermore the Clause leaves open the questions to whether the information must be material or not, and whether the insider must actually intend to use the information to provide himself with a personal gain at the expense of his corporation. Again these are serious defects. Finally and perhaps rather interestingly, it is submitted that apart from these other points the provisions would have absolutely no application to insider trading, as for liability to be predicted the advantage must be improper. Disregarding what the word 'advantage' might mean in this context, insider trading is debatably not regarded as improper, at least under the law as it now stands. Thus it would seem that the mere use of information for personal private speculation in securities would not be prescribed by Clause 1(2).

The Labour Government although in favour of employee participation in management,(877) were anxious to consider what approach would be the most advantageous,(878) and to this end appointed a Committee of Inquiry under Lord Bullock.(879) The Committee was instructed to report as quickly as was possible,(880) and it delivered its Report in January 1977.(881) Obviously this is not the place to discuss the recommendations of the Report other than with regard to insider trading. Both the majority and the minority of the Committee recommended employees participation in management and the Committee's observations on insider trading must be seen in this light. The Committee accepted that both sides of industry were concerned about the question of confidential information, and noted the danger of insider trading.(882) The Committee thought that there should be a clear statement of the basic duties of directors, and that all directors should have the same duties and liabilities. Specifically on the question of insider trading the Committee stated that,

> 'there seems no reason to exempt any director from the duties concerning secret profits or any law which is likely to be enacted regulating insider trading. No director should be able to use information received in the boardroom for personal profits'. (883)

The Committee thought that it was vitally necessary for worker representatives on board of directors to be able to

report back to the employees and make soundings before decisions, although it was considered unwise to make this a specific legal duty. The Committee acknowledged that the ability of worker representatives to report back to employees and trade unions might create problems of confidentiality. The Committee thought that at present the label of confidentiality was too readily applied and that the new management structure which they proposed should embody the ideals of openness. On the otherhand the Report accepted that there was a category of information which should legitimately be considered of a confidential nature and among such was certain types of price sensative information.

It is not without interest that the Committee felt that worker representatives would in most instances be able to sufficiently report back to their constituents without disclosing specific confidential information. It was also pointed out that worker directors would have an obvious interest in not intentionally damaging the commercial facilities of the company, by making rash disclosures. The point was also made that trade unionists and worker representativew were already used to dealing with confidential information in the context of collective bargaining. The submissions of the T.U.C. that confidential information should not be defined in legislation and the normal law of confidence should apply was accepted. The Committee thought that it was undesirable to make any real attempt to lay down in legislation areas of confidentiality as so much would depend upon the facts, and the strength of the contention that a particular project directly effected existing employee interests. In essence the Committee endorsed the Swedish practice where the Chairman and the worker representatives would informally come to some agreement as to what areas should be reported back to the employees.

Apart from the question of statutory provisions increasing the informational expectations of employees and their trade unions, and the promise of mandatory participation in management, many trade unions and employees individually have sought a greater degree of involvement in the framework of collective bargaining.

Indeed the trade unions have been opposed to the concept of participation in management, in the past, and still in many cases are today, because of the inevitable impairment, at least in theory, that joint responsibility of employees in the decisional process brings. Many collective agreements contain provisions analagous to the so called 'Pilkington Clause' which provides 'prior consultation will take place before any change in working practice, methods or payment is implemented, should the change result in dispute between the management and the union the practice shall revert to what it was...and the change shall only be made subsequently should it be agreed upon through existing negotiating procedures.[884] The Commission on Industrial Relations Report on the Disclosure of Information, emphasised that unions frequently obtained considerably more information from their employers than would be available in the company's reports, for the purpose of collective bargaining.[885] Indeed the Secretary of the Association of Scientific, Technical and Managerial Staff, stated in October 1972 that he had asked a hundred of Britains largest companies if they would give the union advance notice if there was any danger of a takeover, or if the company was going to make a substantial investment in another company.[886] A particularly interesting development is that of the creation by the South Wales Branch of the Transport and General Workers Union of an 'Observation and Disciplinary Tribunal' the objective of which is to observe and report on management conduct. The Tribunal will evidently, where appropriate attempt to call persons before it and administer reprimands and recommendations, and in the ultimate there would be the sanction of industrial action.[887]

The problems of the protection of employees 'rights' and the dangers of the provision of privileged advance information are most acute in the case of a corporate takeover or reorganisation. It is now generally accepted that workers representatives should be brought into the plans at a relatively early stage.[888] Certainly there have been a number of recent cases where unions and indeed the employees as distinct from the trade unions have played

a significant role in the eventual determination of the merger or takeover.(889) There would seem to be an ever increasing trend to recognise and afford at least the protection of disclosure to employees in this situation.(890)

Whilst many would be prepared to accept a greater degree of involvement on the part of employees objections have been raised to the reorganisation of corporate structures along the line of the dual board system as widely found and required in Europe. Of course as a matter of practice in all companies there will be a division between those directors who exercise executive responsibilities and those who do not, and are included on the board in an advisory and supervisory capacity. The primary criticism of the European models of codetermination in the British context is the mandatory aspect. It is certainly misconceived to think of increased employee participation solely in the context of the dual board system as participatory models can be devised with a unitary board.(891) Nonetheless whatever model is eventually decided upon, the problems of inside information, and its dissemination and use remain.

It is of some surprise to find that the Trades Union Congress has not made a formal statement on insider trading, 'although the Congress would obviously consider this to be one of the problem areas which will need to be tackled at some time in a companies Bill.(892) The T.U.C. takes the view that the information which would confer an advantage for securities dealings on an insider basis, would only rarely be disclosed privately to negotiators in advance of the public. However, as has been shown above, there is today under the present law and procedures considerable opportunity for union officials and shop stewards to obtain confidential price sensative information. Indeed by virtue of their position and involvement in the enterprise employees are in the nature of 'insiders'. Demands by union officials and others that employees should be afforded rights to examine the corporate books and records to detect managerial incompetence or imprudence, have been faced on occasions, by the argument that apart from the directors, and then not all of such, the workers probably know just as much about the affairs and fortunes

of the company as anyone else. Whilst there is no doubt some truth in this it would seem misguided to maintain that an ordinary production line worker at Fords, is in a position analagous to that of a senior executive, professional adviser or director. It is probable, and yet no reflection on the employee, that even if he was given access to earnings estimates and the like he would not comprehend such.(893) On the other hand the production line workers are in certain instances afforded a semblance of 'insider status'. For example new models of cars and new design variations are displayed and explained to the workers at Fords, 'on a confidential basis'. It is of course interesting to note that advance knowledge of industrial action by a union or group of employees might well constitute 'inside information'.

There can be little doubt that in some instances certain employees will have direct access to price sensative information by virtue of their position, and as a general proposition the more senior position that they occupy the greater will be the occurrence of this 'insider status'. Thus in the Courtline collapse whilst there is little doubt that the announcement of the financial crash of the company came as a complete shock to the vast majority of its employees there were a number of employees and indeed 'travel agents' either in the 'know' or at least so placed to have made an educated guess. The Takeover Panel has had to face unusual cases, where employees who would not normally be considered to be insiders have been able to avail themselves of their 'privileged' position. The former Deputy Director General of the Executive, and Head of the Stock Exchanges Membership Department, Mr.Basil Dennington, informed the present author that in one particular enquiry into an alleged leakage of inside information, the Stock Exchange and Panel found that the employees of a small Midland company were alerted by the managing director coming to work one day in a suit and bowler hat, and his going off to lunch in a hired car with two other directors. In actual fact the lunch was in connection with negotiations for the finalization of a very favourable merger. Certain of the more astute employees evidently invested and made a substantial profit on the basis of this. The Takeover Panel

took no action - perhaps understandably.[894]

It is not without interest that the T.U.C. and others[895] have commented that 'in as much as the development of disclosure of negotiations in advance of the public would lead to less secrecy in business it would also lessen the opportunities for misuse of privileged information'.[896] It is true that there comes a point where the information is so widely known that it could be said to be fairly within the public domain, but it would seem that the T.U.C. is not necessarily concerned with this. Merely to increase the number of persons with access to material price sensative information before public disclosure is at best to invite trouble, particularly where the use that such information is put to would be wholly unregulated by law or any self-regulatory regime.

The Trades Union Congress has not given any guidance on the handling of inside information, and denies that its own officers would in any appreciable number of cases ever have possession of such. In a small survey carried out by the author[897] it was found that the trade unions sampled, were either ignorant of what insider trading was, or considered that their officers and members would be most unlikely to ever acquire inside information. Indeed some trade unionist appeared resentful that they should be even asked whether they operated internal procedures with regard to confidential information. In no case was it found that the Trade Union was adequately aware of the dangers and had taken any real steps to impose restrictions on the use of such information by its members or officers.[898] This approach is disturbing and shows a lack of true responsibility, or at least understanding.

CHAPTER III

THE REGULATION OF INSIDER TRADING IN THE UNITED STATES OF AMERICA

(I) WHO IS AN INSIDER UNDER RULE 10b(5) OF THE SECURITIES EXCHANGE ACT 1934.

(2) TIPPERS AND THE PROBLEM OF THE SECURITIES INDUSTRY
- (A) SECURITIES PROFESSIONALS AS INSIDERS AND TIPPERS.
- (B) INSTITUTIONAL INVESTORS AS INSIDERS AND TIPPERS.
- (C) SEGREGATION OF BROKER-DEALER FUNCTIONS ON THE STOCK EXCHANGE.
  - (a) SEGREGATION IN THE UNITED STATES OF AMERICA
  - (b) SEGREGATION IN THE UNITED KINGDOM
- (D) TIPPING AND TIPPEE TRADING AND THE QUESTION OF CIVIL LIABILITY
- (E) THE DEFENCE OF IN PARI DELICTO
- (F) MARKET INFORMATION OR OUTSIDE INFORMATION

(3) SECURITIES MARKETS SURVEILLANCE AND TIMELY DISCLOSURE IN THE UNITED STATES OF AMERICA
- (A) SURVEILLANCE OF SECURITIES MARKETS
  - (a) N.Y.S.A.
  - (b) A.M.E.X.
  - (c) N.A.S.D.A.Q.
  - (d) SECURITIES EXCHANGE COMMISSION.
- (B) TIMELY DISCLOSURE
  - (a) N.Y.S.E.
  - (b) A.M.E.X.
  - (c) N.A.S.D. AND N.A.S.D.A.Q.
  - (d) EFFECTIVENESS OF SELF-REGULATORY TIMELY DISCLOSURE POLICIES.
- (C) THE SECURITIES EXCHANGE COMMISSION AND TIMELY DISCLOSURE
  - (a) TIMELY DISCLOSURE - A LEGAL REQUIREMENT
  - (b) THE PROBLEM OF DISSEMINATION.

THE REGULATION OF INSIDER TRADING IN THE UNITED STATES OF AMERICA

The present author has great reservations as to whether a discussion of the topic of anti-insider trading regulation is feasible without detailed reference to the great wealth of experience in the United States of America, and for that matter, elsewhere. It is thus with great reluctance that the three chapters that the present author had originally written on the American law has been excluded almost in total, and a further two chapters on anti-insider trading regulation throughout the world have been omitted, save for the law in Canada and Australia. Apart from the great advantage that comparative analysis can afford to the drafting and administration of such laws, given the internationalisation of the securities markets, a knowledge of the relevant law in other countries is often vital. However, it is not, and cannot be, the purpose of this present study to provide a text on the whole area covered by anti-insider trading regulation,(1) nor a practical guide, even on the few aspects that it does comprehend.

The regulation of insider trading in the United States, both with regard to legislation and common law development, and also through self-regulation, has attained the highest form of development in the world. No legislator or lawyer required to consider the problem of insider trading, could afford to ignore it. The concepts of materiality, privity, scienter, causation and damage, are the same in virtually all forms of anti-insider trading regulation. The statutory short-swing profits rule attempts to provide the benefits of predictability and automatic application, albeit at the expense of fairness in some cases. The continuous disclosure regime, and provisions designed to ensure disclosure of insiders beneficial interests in securities are similarly the most effective provisions in operation in any system of securities regulations. Fortunately the present study does retain two sections, which in the present authors view are probably the most important factors in effective anti-insider trading regulation; that is the definition of insiders and tippees, and the system of market surveillance and timely disclosure.(2) It is

regretted that in raising these issues, other extremely important questions arise which cannot be pursued here. It is hoped that the reader will fully appreciate the problems created by such an approach and excuse the inevitable unanswered questions and unexplained references. It is of course true that a vast amount of material has been written on the regulation of insider trading, and associated matters in the United States, and in recent years a number of works have also appeared describing insider trading regulation in certain European countries.(3)

(1) WHO IS AN INSIDER

Unlike in the case of Section 16(b) there are no precise definitions of who is and who is not an insider under the relevant principles of Rule 10(b)(5). (4) Indeed under Rule 10(b)(5) the relevant question is not so much whether the particular person, who it is sought to make liable is an insider, whatever such a term may mean, but whether there has been an abuse such as is within the scope of the implied liability created by the rule. A prior catagorisation is irrelevant and dangerous. However, in the nature of things, it is necessary to determine what kind of person and situations are most likely to be within the provision.

Generally under the Federal Securities laws responsibility flows from control status, and this is as good a starting point under Rule 10(b)(5) as anywhere. However the imposition of the so called 'abstain or disclose' rule is not matched perfectly to control status, as is the recapture liability under Section 16(b). Whilst directors and officers are almost certain candidates for responsibility, (5) as are substantial shareholders, (6) beyond this, little can be said with the degree of certainty generally accepted as desirable. Consistently with common law decisions, (7) it was accepted in the Texas Gulf Sulphur case that corporate employees can properly be regarded as within the scope of 'insider' responsibilities under the rule. (8) In the District Court, Judge Bonsal stated 'if an employee in the course of his employment acquires secret information relating to his employers business, he occupies a position of trust and confidence toward it, analagous in most respects to that of a fiduciary, and must govern his actions accordingly. (9) The SEC in its Pre-Trial Memorandum was even more explicit, 'any corporate officer or employee who in the course of his duties has been entrusted with knowledge of a material undisclosed fact becomes with respect to that fact an insider.' (10) There is no indication how far this approach extends through the corporate hierarchy and might well comprehend the most menial of employees.

Commissioner Budge has, however, commented that normally the SEC would not pursue 'rank and file employees or persons outside the companu such as an analyst or reporter who learns of inside information! (11) Judge Bonsal's test was expressly endorsed and applied by the same Court in Ross v Licht (12) and would accord with the statements on insider status in other cases, and would thus represent the law with regard to employees.

The bulk of federal cases dealing with insider liability in recent years have spoken in terms of 'access to insider information' as the appropriate determinant of status. The first authorative ennunciation of this approach was by the Commission in the Matter of Cady Roberts (13) whichwas endorsed by the Courts in Texas Gulf; (14) the obligation of insiders rests on two principal elements, first the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.' This test can be applied to anyone, (15) the determination resting on the question of access and unfairness. (16) Thus an 'insider' is a person who because of his position or intimate association with a corporation has a greater knowledge of the financial affairs of the corporation . (17) In practice the access test inevitably results in certain catagories of person by the very nature of their position being regarded as insiders, and paramount among such will, of course, be the traditional insider relationships. However, these 'by no means exhaust the classes of person upon whom there is an obligation', this much was emphasised by the Court of Appeals in Texas Gulf Sulphur. (18)

It is important to note the shift of emphasis that the 'access test' brings about. In effect the inquiry is redirected to the type of information which can be considered of a sufficient privileged status, to produce liability, where there is an access relationship. It is the individuals relationship with the information, and a particular and unusual type of information, that is critical, and not the individual's relationship with the corporation, although of course the

latter relationship will bear upon the former. Thus the definitional problems are transported to the determination of what constitutes insider liability information. For instance, Bromberg comments 'trading by persons with undisclosed material information is generally a violation of Rule 10(b)(5)'.(19) Exactly what degree of 'access' to this category of information is required for applicability of the Rule, is open to question. Professor Bromberg comments that 'probably something more than possession of the information is necessary ... probably it means possession intended to fulfil a corporate purpose' of the company to which the information relates.(20) The concepts of access and possession are difficult to apply and lend themselves better to academic and jurisprudential discussion than to cold application and administration.

Although logically the access test is capable of finding insider status even though there is no relationship with the corporation, 'as a practical matter' the test is only applied upon some basis of a relationship giving access with the corporation, and thus a corporation-individual relationship is necessary.(21) Thus two categories of potential defendant emerge, firstly, the defendant who acquires 'liability information' because of his position, the traditional insider and the category of person who are within the scope of the generally accepted principle that 'those in power should not make use of confidential information for private gain',(22) and then secondly the other defendant who merely comes into possession of inside information not necessarily because of any position that he might hold. This latter category is preferably designated that of 'tippee-insiders'.(23) Obviously in practice there are numerous cases where it is extremely difficult to decide whether a given individual is properly to be regarded as within the category of primary 'access insiders' or the secondary category of 'possession' insiders.

There is a particularly troublesome group of persons who do not fit in with any great harmony to either category of insider. There are persons who, whilst not

retained or employed with a particular issuer, nonetheless are in a position to receive 'inside' information. Among these persons are investment consultants, management consultants, financial advisers, lawyers, accountants, public relations advisers, and a host of others, who whilst not traditionally conceived as insiders, might well be insiders through access or possession. (24) Although there has been virtually no judicial or administrative discussion of the exact status of these persons largely because the discussion has centred more on the nature of the information concerned, and whether such is properly to be considered inside information, it would seem that these persons are more generally regarded as coming within the second category of insider. There are indications that the Commission has become alert to the desirability for clarification in this area, and has in recent years been increasingly more prepared to file complaints alleging insider abuse by such persons.(25) Thus it would seem that whether these categories of 'insiders' be regarded as 'access insiders' as are traditional insiders or as 'tippees' their liability will still be predicted upon Rule 10(b)(5).

Whatever liability is properly placed upon insiders, particularly of the traditional type, it could easily be evaded if those persons immediate family were not accorded the same treatment. (26) The problem here is to avoid the erection of a liability structure of imponderable dimensions. The Commission has long considered that 'intimacy' with the source of the inside information demands restraint, lest the uninformed be exploited. (27) Thus to the ends or eradicating the essential unfairness of insider trading the Commission will attempt to subject trading by insider's wives or husbands, near relatives and business associates to the same strictures as the insider. Whether the spouse or associate is to be considered as an insider, properly so called, or a tippee-insider, is debatable. Furthermore, where the insider is himself

only a tippee, it is open to question whether the spouse or associate of such would be caught, as such is in effect a tippee of a tippee. (28) As to the liability of tippees themselves, this will be discussed later. The Court of Appeals in the Texas Gulf Sulphur case treated purchases by the defendant's wives as though they had been made by the insider himself, and simply dismissed any alternative argument as 'unrealistic'. (29) In another case a plaintiff sought relief against members of an insiders family for their transactions, alleging that they were both insiders and tippees. (30) Thus although there is very little law on the question of dealings by members of insiders and tippees families, it would appear accepted, as in the case of section 16(b) that dealings of a spouse or unemancipated child, and probably other close relatives, will be treated as those of the insider. The New York Stock Exchange has stated emphatically that members of insiders families and their associates are regarded by the public as insiders themselves and 'while this assumption may be unjustified in many cases, it is a fact of life which those in a position of leadership and responsibility cannot ignore. (31) Whilst this extension of liability does create problems, particularly given the uncertainties as to the primary liability of insiders, it has to be remembered that the Courts are applying broad equitable principles and 'there is no need to become entangled in a semantic classification to establish liability. If an insider analysis is inappropriate, a tippee approach will reach the same result. (32) It is thus necessary to consider the much wider area of tippee liability in some depth, before any notion of the scope of possible liability is obtained.

(2) TIPPEES AND THE PROBLEM OF THE SECURITIES INDUSTRY

(A) SECURITIES PROFESSIONALS AS INSIDERS AND TIPPEES

If it is impossible to estimate with any degree of accuracy, how much insider trading goes on, it is all the more difficult to express any view as to the extent of tippee trading. An anonymous American stockbroker writing under the name of Brutus, has observed 'there are numerous psychological reasons why persons give tips to each other-love, guilt, friendship, insecurity, reciprocity, are all good reasons. (33) It is doubtful that the extent of tipping of inside information is anywhere near the proportions suggested in the writings of Professor Manne. (34) Manne considers that it is probable that a market for the exchange of valuable information operates on a large scale in the United States'. (35) Wherever securities markets exist it would seem rumour and, significantly, educated guesses, which are often the close cousin of insider 'tips' play a major role in the determination of individual investment decisions. (36) From the moral point of view there is great difference in an insider properly so called, who has been entrusted with access to certain information abusing such in his personal transactions, and the position of someone who merely has the information placed into his hands, a distinction in many ways similar to the thief and the receiver of stolen property. In cases involving breach of trust, a person assisting the trustee in the violation with knowledge or reasonable grounds for suspecting an abuse, will be placed in the same position as that fiduciary. (37) However, where the conduct of the non-fiduciary falls short of 'knowingly confederating in the breach' or assisting with knowledge' then there would be no such liability on the part of the non-fiduciary. Similarly under Rule 10(b)(5), Loss has commented that 'to hold tippees liable under Rule 10(b)(5) when they had no reason to suspect that their informant was an insider might result in an unreasonable entrapment of the innocent...' (38).

A particularly troublesome aspect to any concept of tippee liability, is the position of those persons whose function or activity inevitably exposes them to the receipt of material price sensative information. There are obviously many in the securities industry itself who are constantly in receipt of inside information, and in most cases not through an 'access relationship' as such. The rationalisation of the law in this area has been slow and of a deficient nature, so that substantial uncertainty exists both as to the parameters and extent of liability.

There is an obvious public interest in the most efficient and sensible allocation of scarce capital resources to particular enterprises, and of vital significance here, is the question of disclosure, as has already been seen. The disclosure regime in practice, and many contend in aim, is and should be directed primarily at the securities professional, who functions as a conduit and adviser to the providers of capital and investors. Given this factor, and the role of the securities professional as an adviser and thus (searcher for informaton' it is undoubtedly the fact that persons engaged in the securities industry are likely at any given time to be in direct and indirect receipt of considerably more information, with a much higher threshold of intelligibility than the ordinary investor. This is their very raison d'etre (39) Apart from the securities professionals legitimate quest for investment information, he is faced with a number of other areas of possible conflict. For a variety of reasons, among which is to increase the availability of information, securities firms and investment bankers often have nominees or representatives on the boards of corporate issuers, with which they might have underwriting agreements. Furthermore there is an increasing trend for investment managers and institutional investors to recognise the responsibilities of their large holdings and to become involved with corporate

...

management. (40) Whilst many securities houses appoint 'outsiders' to these positions (41) their nature hardly alters. As far back as 1958, Lehman Brothers directors and partners held 170 directorships in 128 listed companies, with assets of over $100,642,000,000. (42) 'This centralisation ofimportant directorships concentrates in one group of men, maximum access to inside information, maximum power to use inside information'. (43) This would seem to be by no means an unusual situation. (44) Securities professionals also obtain inside information through their dealings as underwriters and corporate advisers even where there is not formal board representation. Commercial banks, by reason of their very function, are in possession of information as to the finances of their corporate clients, and are thus in a position to be considered an 'insider'. (45) Given the inevitable possibilities of access and possession of inside information, there are considerable potentialities for conflicts of interest. Securities professionals and Banks perform a multiplicity of roles, and apart from direct investment management and investment advice, such will have dealings with other corporations, to all of whom there will be varying duties of either disclosure or non-disclosure. (46) In addition there is the possibility of misapplication of the information by the securities firm and its officers directly for their own personal interests.

Where there is any 'privileged' access or possession of inside information and also a duty to advise on investments, there will be a conflict of interest. Securities professionals giving investment advice under the Commissions suitability rules and the so-called 'shingle theory', are bound 'to obtain current basic information regarding the security ... and although some customers will independently determine to purchase or

sell specific securities and will not request or desire the advice of a broker ... the broker would appear to be obliged to reveal to the customer information known to him about the security which might reasonably be expected to affect the customer's decision ...' (47) In seeking out and providing vital investment information to both lay and professional investors and their advisers, of vital importance is the investment analyst. At all levels of the industry there are both real and theoretical fundemental conflicts and a profound uncertainty as to what sources of information can be legitimately utilised and to what extent the resultant information can be capitalised upon. Obviously, as in other 'shadowy areas' of the law, this results in undue advantage to the unscrupulous. Although 'the vast majority of the so-called 'tips' which float around the customers rooms of brokerage offices are worthless' (48) professionals engaged in the securities industry are in a far better position to evaluate such than the ordinary investor. Furthermore, persons engaged in the securities industry are better able to utilise the privileged information, and to do so in a mannerthat is either difficult or impossible to detect. (49) The ways in which professional advisers and analysts will utilise privileged information are, of course, multifarious. Information can be included in intrafirm reports and ,arket reports, (50) incorporated into general investment circulars, utilised directly in the management of portfolio investments and direct notification to special and selected clients. Given the significance of commission earnings on institutional investor clients, securities firms would appear to give such preferred treatment. During the Senate Hearings on Stock Exchange Practices the use of 'priority lists' by brokers was found to be reasonably widespread. (51) The Chief Examiner, Ferdinand Precora, thought that such might be used for 'mutual

backscratching' by insiders. (52) Although Professor Manne has fastened upon such as supporting his notion of a sophisticated exchange market of insider information, there are perfectly sensible and unobjectionable reasons for such lists. Obviously a securities house with many thousands, perhaps millions, of clients spread over a widegeographical area, could not hope to inform all simultaneously of significant corporate developments. (53) Provided clients are made aware that the firm does operate a preferential list or an alphabetical list, then the practice is acceptable. (54) Professionals in the securities business have not, in the past, been loath to utilise privileged information personally, nor trade on the basis of expected market impact of their own releases. (55)

Turning now to the question of regulation, the first case to indicate that a professional engaged in the securities industry could be liable as an insider or tippee under Rule 10(b)(5) was the Commission's disciplinary action in the matter of <u>Cady Roberts & Company</u>. (56) The facts of this case have already been alluded to in the prior discussion of deputization. The proceedings were brought against Cady Roberts itself and Gintel, one of its partners for alleged violations of Rule 10(b)(5), and also section 17(a) of the 1933 Act. In the result both defendants entered into a settlement with the Commission that the record would show the facts as stipulated by the Commission, provided that the only sanction that was administered was not greater than a temporary suspension of Gintel for not more than twenty days from the New York Stock Exchange. The Commission seized the opportunity for emphasising that Rule 10(b)(5) and section 17(a) were broad remedial provisions designed to protect investors, and the requirements of these provisions were not precise and technical as those of the common law, but were intended to prescribe all deceptive

and manipulative practices. (57) The SEC found the misrepresentation in the 'affirmative duty todisclose material information ... traditionally imposed on corporate insiders, particularly officers, directors and controlling stockholders. 'Until this opinion, it was not clear whether a mere non-disclosure would be considered a misrepresentation under the Rule. Whilst there were decisions imposing upon brokers, the duty to make a full disclosure when dealing on their own account, this was based on an implied representation, (58) similarly, those cases where brokers have been held liable for failing to disclose material information when effecting transactions for insiders, (59) have been based on conspiracy and aider and abettor notions. Thus the Commission extended the affirmative obligation upon (insiders' to disclose material non-public information considerably further than any other previous decision on Rule 10(b)(5) liability. The SEC emphasised that the obligation was equally applicable to exchange and face-to-face transactions. (60) Although the defendants had cited a number of cases indicating that some form of privity was required for liability, the Commission considered that this was not the case in administrative actions. Chairman Cary stated 'the absence of a remedy by the private litigant because of lack of privity does not absolve an insider from responsibility for fraudulent conduct.' (61) The Commission further emphasised that the obligations imposed under Rule 10(b)(5) were in no way limited to persons occupying a fiduciary status. (62) It was also confirmed that the rule applies to both purchases and sales of securities.

As has already been observed, the Commission in the present case considered that the duty rested upon the 'existence of a relationship giving access' to information intended to be available for only a corporate purpose and 'the inherient unfairness involved where a party takes advantage of such information, knowing it is unavailable

to those with whom he is dealing.' (63) Applying this, the SEC considered that Gintel's close relationship with the corporate insider should subject him to the same duties and responsibilities as were applicable to the insider himself. (64) The duty, enounced by the Commission was

> 'that insiders must disclose material facts which are known to them by virtue of their position, but which are known to persons with whom they deal and which, if known, would affect their investment judgement. Failure to make disclosure in these circumstances constitutes a violation of the anti-fraud provisions. If on the hand disclosure prior to effecting a purchase or sale would be improper or unrealistic under the circumstances, we believe that the alternative is to forego the transaction.'

Thus here as Gintel was in the same position as the insider-director, he was precluded from dealing without disclosure, and this 'prohibition extends not only over his own account, but to selling for discretionary accounts and soliciting and executing other orders.' The SEC left open the question of unsolicited orders however. It is important to note that the Commission considered that the transactions were still objectionable even though the broker had no direct interest therein. This is obviously logical, as otherwise great possibilities for evasion would arise. Moreover, brokers and professionals in the securities industry have a very real interest in the money that they make or save for their clients. This has a direct bearing on the retention and attraction of clients, and thus on commission earnings and prestige, and possible increased access to privileged sources of information.

(65) The defendants argued that the Commission were contending for disclosure of 'adverse factors disclosed by his analysis' which would create uncertainty and confusion as to the duties of those whose profession it was to acquire and analyse corporate information.

The Commission did not really answer this, but did admit that in certain cases 'there may be a question as to the materiality and significance of some corporate facts and as to the necessity for their disclosure under particular circumstances. 'Furthermore, Chairman Cary pointed out that in the present case the relevant information had not been the product of an indepth analysis of public information, but was obtained from an insider in breach of his duty to the corporation. In cases of doubt, the SEC underlined the fact that the broker always had the choice of refraining from the transaction or recommendation. In the present case this course would have been perfectly feasible as disclosure by the corporation was imminent. Of course, the difficulty with placing such a disclosure obligation on professionals engaged in the securities industry, is that unlike insiders properly so called, they are not generally in a position to influence the corporate decision and machinery to effect disclosure. Indeed, as one learned commentator has remarked, 'in many cases disclosure by the broker of confidential information would involve his participation in the insider's breach of duty to his corporation.' (66) Whilst the simple disclose or abstain rule provides a very good general princilpe, in certain instances it could impinge upon the proper functioning of a broker and his duty to his clients. In the present case Gintel claimed that he had already decided to off-load, Curtis-Wright shares, and had already commenced liquidation before receiving the inside information. Furthermore he contended that 'he had a fiduciary duty to these accounts to continue the sales which overrode any obligations to unsolicited purchases on the exchange'. Chairman Cary rejected the argument that the sales subsequent to the receipt of the inside information were merely part of the prior programme of liquidation, as the sales previous to the 'tipping' were both moderate and relatively insignificant.

Furthermore, Gintel had 'gone short' both for his wife's account and that of another 'mysterious investor'. Whilst he unquestionably occupied a fiduciary relationship with his clients, this could not justify violations of the law, and the Federal Law was here supreme. Thus the Commission stated that 'on these facts, clients may not expect of a broker, the benefits of his inside information at the expense of the public generally.'

Although the Commission had accepted the settlement of the complaint, the opinion did discuss the question of sanctions. Chairman Cary thought that this would depend upon 'all the surrounding circumstances and the state of mind of the participants'. Whilst there was no evidence of a 'preconceived plan' the SEC considered that there was no question that Gintel's conduct had been deliberate, in that he knew what he was doing, although it was accepted that the insider probably thought that the information was already public. The Commission considered that Gintel had acted spontaneously, not considering the possible implications of his actions, and there had been no opportunity for Cady Roberts & Company to exercise any internal supervision, nor for Gintel to give proper consideration and deliberation to his responsibilities. In the result given the fact that Gintel had been fined $3000 by the New York Stock Exchange, the SEC merely suspended him in accordance with the offer of settlement for twenty days. (67)

Although the Commissions decision is unexceptional, apart from the moderacy of the sanctions applied, the opinion gave only scant attention to the reasons for finding Gintel liable. Gintel's liability was obviously justifiable on the notion that both he and the insider formed a single 'economic unit' with identity of interest, or upon the notion that the tippee in point was a broker with extended responsibilities to the market.

However, Chairman Cary, after finding that the insider could not deal without disclosure, added that 'by logical sequence' nor could his tippee. What rationale for the chain of liability the Commission based this upon, was left unarticulated. It is conceivable that the Commission were in actual fact speaking of a liability based upon 'unfairness' rather than upon predefined relationships, and thus because of the novelty and momentus aspect of the rationale, it was considered prudent to leave the rationale obscure. Although the Commissioners did refer to 'special relationships with a company' that would give access to inside information; what factors determined such were ignored, and after all Gintel was a mere business associate of the insider, (68) and occupied no relationship at all with the corporation. Thus it is hard to escape the conclusion that this factor was of critical importance to the finding of liability. (69) The relationship was created by the knowing receipt of inside information in unfair circumstances. This is supported by the comments of Cary, made elsewhere, when he was 'summarising' the rationale of the decision,' ... the Commission's action was based on the obligations of insiders not to take advantage of the nonpublic information that was disclosed for a corporate purpose, and not to give a one-sided advantage through this medium in trading transactions. (70) It is important to note that the Commission in this case thought of Gintel as an 'insider' and not as a special subcategory of insider having obligations different in nature from the real insider, the director.

Given the vast extension of liability in this case and the conceptual uncertainty there was obviously widespread dissatisfaction in the industry. The learned writer in the Yale Law Journal (71) proffered three guide lines for brokers and professionals in the industry, on the basis of the Cady Roberts decision.

Firstly, the broker should decide whether the information is true or is merely rumour or opinion; secondly, is it information which, if disclosed publicly, would be likely to have a significant effect on the market price of the securities; and thirdly, is the information already available, to even some extent, to the public. It has often been said that the vast majority of tips that float around the customers rooms of the brokerage offices are worthless.' (72) Thus it is necessary for the receipient to separate the chaff from the wheat. With regard to the determination of materiality, the broker must decide whether viewed in retrospect, the particular piece of information he has received would have been price sensitive, standing alone, or possibly with other pieces of information similarly obtained. The market and any particular investment decision therein will not in the most part, be determined or primarily influenced by a single identifiable event, but a concaternation of circumstances, prejudices, and emotional factors apart from 'known' and 'unknown' information. Hardy writing in 1923 stated 'all this news and all these factors and rumours and tips which are poured into the 'financial hopper' have a certain influence on the minds of traders and investors, causing them directly or indirectly to buy or sell' (73) Of course there will be cases such as the Texas Gulf Sulphur mineral strike where it is patently obvious that the market and the vast majority of individual transactions therein are influenced by a single identifiable event. In most instances the securities professional receiving possible 'liability information' is truly on a knife edge, as if he makes a false determination that the information is 'tainted' and thus rejects it, if it is later found to have been unobjectionable, he will be hard put to explain his position morally and legally to his clients, particularly those having discretionary accounts.

Furthermore, in the vast majority of instances this crucial decision will have to be arrived at almost instantaneously as Gintel's was in the Cady Roberts case. There will be precious little chance for verification of the information or itsstatus. Indeed the broker possessing this type of information is faced with the choice of seeking outside advice and possibly being held to have tipped inside information, if such the information proves to be, or having to share with others profitable investment information if it proves to be useable, or failing to seek verification and thus substantiate allegations of unreadonableness. Moreover, if the broker is considered to have a duty to investigate the source and status of the information, nice questions arise as to what lengths he should go to in determining whether the information is traceable to an insider. Of course, there are occasions where although the broker is aware that the information is of a privileged nature he is unaware of the exact source and circumstances of disclosure. For example, an American broker has stated that he received good 'tips' from the neighbour of the mistress of an insider; indeed he writes, 'tips from the bedroom are the only tips that I believe,' (74) In practice it would seem that brokers and professionals in the industry are not as reluctant to be influenced by tips as one might consider, when reading the pronouncements of the industry organisations. (75) Furthermore, it would seem that such will delight in carrying the account of an insider, as even if there is no direct tipping, the trading orders of the insider will provide a mine of useful guidance, at least for a cynic. Reference has already been made to the story of 'Large Phillip' and even Hardy comments that it is customary for a broker who sees inside orders coming through to advise certain clients in accordance therewith, without necessarily disclosing the actual source. (76) Brutus describes how one of his 'favoured clients' who id a small investor, works for a large mutual fund and has 'access to big information'.

(77) The anonymous broker states that 'he follows his coat tails putting his own managed people into the same stocks'. (78) Of course, brokers and professionals are not solely benevolent in their utilisation of inside information and are just as likely to use it for their own or associates dealings.
(79) The obligation upon brokers to 'check-out' their information and sources, as well as their clients, is not as onerous as it might at first appear. The New York Stock Exchange, as well as the other national securities exchanges require each member firm to possess and keep up to date relatively complete sets of data on the business connections of their clients, and spouses of such.
(80) The 'know your client' rule is a particularly important one from the point of view of market surveillance and the SEC's suitability rules, and reference will be made to it elsewhere.'

Of course, the question as to whether the information is reliable or not will almost inevitably merge with that directed towards materiality, and in both instances of crucial importance will be the circumstances in which the information was received. (81) The third question, that is whether the information has been sufficiently made publicly available, so as to eliminate the question of unfairness, will be a difficult one for the tippee, as he will not be in a position of such intimacy with the corporation to know whether the information has been released other than by the more obvious media, nor will he be aware of the issuers disclosure policies. Another serious problem in this field is where the brokers decision to trade or recommend is in large measure the sole result of his own analysis, and the information that he receives is merely confirmatory. Obviously there is a strong public interest in not unduly penalising analysts in this situation and there is a valuable aspect to the encouragement of efficient and honest analysis. The Cady Roberts decision left open how these considerations were to be balanced.

The spate of recent cases 'following up' the Cady Roberts decision have had a tremendous impact on the American securities industry and naturally the law on insider trading. The vast increase on SEC enforcement in this controversial area was marked by the commencement of administrative action for alleged violations of Rule 10(b)(5), against the Wall Street giant Merril Lynch, by the Commission's Division of Trading and Markets. (83) The action was brought against the firm, and no less than fourteen of its officers and salesmen, not to mention some fifteen institutional investors.
The Commissions staff alleged that the stipulated officers and salesmen of Merril Lynch during the period between June 20th and 23rd 1966 disclosed material nonpublic information about Douglas Aircraft Company and its earnings, which it had obtained in connection with an underwriting of Douglas'. debenture stock.
It was further alleged that certain of the customers of Merrill Lynch after receiving this information sold and in certain instances, went short, prior to the public disclosure of the information. Moreover, the Staff contended that during the relevant time Merril Lynch effect on behalf of other customers purchases of Douglas stock without disclosure of the relevant information. The Staff then also charged independently the institutional investors for obtaining the material nonpublic information from Merril Lynch and then dealing upon the basis of such, without making proper disclosures thereof. In connection with these transactions Merril Lynch received consideration in the form of customers 'give-ups' and commission from the execution of the transactions. The firm offered a settlement of the complaint, which the Commission accepted. Under this, Merril Lynch agreed to the infliction of certain penalties, which included public censure, fifteen and twenty-one days suspensions of two branch offices, suspension without pay of certain officers, managers

and salesmen, and internal disciplinary action.
(84) The Commission cited the Cady Roberts decision and the Court of Appeals decision in the Texas Gulf Sulphur case for the proposition that it was a violation of Rule 10(b)(5) for an insider to tip information to a non-insider. The SEC rightly considered that the unfairness was aggrivated by the selected disclosure to some clients, whilst at the same time effecting contrary transactions for other clients without disclosure. (85) It is not without interest that in addition to the penalties already mentioned, under the terms of the settlement Merril Lynch agreed to adopt a statement of policy designed to insulate any confidential information that its corporate finance and underwriting department might receive from personnel in the advisory and trading departments of the firm. The firm also promised to use its best efforts to insure prompt disclosure of information that it might learn in an underwriting.

Perhaps of potentially greater significance than the case against the brokers, was the allegation made against the fifteen institutional investors. The jurisdiction of the SEC. in these cases was based upon section 15(6)7. which permits the Commission to proceed administratively against anyone associated with a broker-dealer, or who might be associated with such in the future. (86) A number of these large funds maintained that because of their fiduciary responsibilities to their clients to use the fund resources to the best of their ability, once they hear of inside information they are bound to act thereupon in the best interests of the fund. As one fundmanager stated, 'apparently we're dammed if we do and we're dammed if we don't.'
(87) Although the SEC dropped its action against two of the funds, the action was continued against the remaining thirteen.

(88) It appeared from the SEC's investigation that the information had been conveyed by personnel in the underwriting department directly to several institutional salesmen, who then contacted the funds and imparted the information in specific terms. Subsequently several of the defendants discussed the information at a luncheon. The SEC's Hearing Examiner found that twelve of the respondant funds had traded with actual or constructive knowledge that the information that they had received from Merril Lynch was material, price sensitive and of a non-public nature. (89) The Examiner expressly held that the scope of Rule 10(b)(5) was much greater than mere access insiders and comprehended those who obtained inside information through an insider. Here the information had been given to Merril Lynch as a managing underwriter and not for the personal benefit of the firm or its clients. The Examiner made much of the essential unfairness of this, and stated 'one who obtains possession of material non-public information which he has reason to believe or to know emanates from a corporate source, and which by itself places him in a position superior to other investors ... is within the purview and restraints of the anti-fraud provisions.'

(90) The acceptance by the Hearing Examiner that constructive knowledge is sufficient at least in administrative proceedings confirms the view that there is a duty upon a recipient of information to check its status and source. (91) The Examiner dismissed the action against the final fund - the Dreyfus Corporation on the grounds that the decision to sell had been taken by someone not in possession of inside information.

As the primary questions of law were ones of first impression and of great importance the Commission granted a review of the Examiners decision of its own motion.

(92) In the result the Commission affirmed the decision of the Hearing Examiner and imposes a sanction of public censure. (93) The SEC accepted the point raised by the Division of Trading and Markets to the effect that the potential for abuse and consequential damage to the market in the case of tippee trading by the large investment funds was far more serious than ordinary incidents of insider abuse, because of the sheer size of the transactions involved. (94) The Hearing Examiner had based his finding of liability on the actual or constructive knowledge on the part of the defendants that the information was non-public and had eminated from an insider in violation of a corporate purpose, and thus improperly. The Commission approved this additional factor of knowledge on the grounds that without an appreciation that the information had been improperly obtained, there is no real element of unfairness. In the case of a traditional insider or a person in an access relationship with an issuer, it can be taken for granted that the recipient of price sensitive information will know that he should not trade on the basis of such, because of his relationship with the corporation. There is no necessary implication that an outsider recipient of information will appreciate that it is material, non-public information obtained in breach of a fiduciary obligation or in violation of the corporate purpose. In the words of Commissioner Smith, the recipient 'must know or have reason to know, that the material non-public information became available to them in breach of a duty owed to the corporation.....' In essence this is similar to the common law notions of liability for those assisting in a breach of a trustee or fiduciary's duty, which has already been mentioned.

Thus although it has been maintained that the present approach amounts to a substantial modification of the access test as laid down in the matter of Cady Roberts & Company, and in subsequent court cases, [95] given the fact that those cases were concerned with the liability of a person in an access relationship where such 'tipped' inside information and not the liability of the recipients there of, it is dubious whether this view is justified. All that the present decision does is to emphasise the true criteria, that of unfairness, more clearly. [96] It would seem that in the case of tippees, the information must be provided through an insider properly so called. Whether there must be a relationship with the issuer as such, would appear highly dubious. Although General Counsel Philip Loomis considered that such was necessary at the Financial Analysts Federation Conference in 1968 on Corporate Disclosure and Insider Information, it would seem enough that the tippee appreciated or should have appreciated, that he was obtaining inside information in breach of a corporate purpose. There remains the problem of the recipient of privileged information who does not have an appreciation that it comes from an insider or who has no relationship with the insider. If the net is cast so as to catch either of these situations, there would be a substantial uncertainty as to the limits of liability. The Commissions statement would certainly be wide enough to catch the tippee who, whilst appreciating that the informant was an insider, had no relationship whatsoever with him or the corporation. [97] It is important to appreciate that the present case was an administrative proceeding purely within the jurisdiction of the Commission, and thus the SEC was able to fashion a remedy - that of public censure to fit the expanded notion of responsibility for liability information.

The Commission affirmed the supremacy of the duty to abstain or disclose under Rule 10(b)(5) over the existence of possible fiduciary duties at state level to utilise the information for the benefit of the clients or fund investors. However, given the extended and vaguer standard of liability laid down in the present opinion recipients of information are placed in a dangerous position. To escape a suit at State Law, it would appear that the defendant would have to establish all the elements of a Rule 10(b)(5) action against himself, on the assumption that he had traded. Obviously this is a scant protection, and poor guideline for a busy professional to apply in the determination of whether the information is useable. (98) Both Cady Roberts and the present proceedings were administrative, and at least in the context of privity in Cady Roberts, the SEC pointed out that different considerations might pertain in civil suits before the courts. Of course the Commissions proceedings did have the important aspect of identifying potential defendants, a most useful factor in tippee cases, (99) and in the present case a number of private civil suits were commenced against the defendants. (100) The most interesting for the present discussion was that brought by the Financial Industrial Fund, (101) against both Merril Lynch and McDonnell Douglas Aircraft Corporation, the issuer of the relevant securities. Although the facts of the case are complex, it suffices here to comment that the Financial Industrial Fund had been a substantial market purchaser of Douglas stock immediately prior to the announcement of the low dividends and cuts in estimated earnings, which had a substantial impact on the market price and resulted in losses of $2,000,000 on sale, for the plaintiff. The action was

based on Rule 10(b)(5) and alleged that the cirporation and underwriters had not made a prompt disclosure of the information. The District Court of Colorado submitted the case to the jury on the basis that there would be a violation, if the information was withheld from the market, so as to facilitate the redemption of outstanding debentures and the marketing of new shares. The jury found liability and assessed damages at $ 700,000. and the Court sustained the verdict and rejected the defendants motion for retrial.

(1o2) District Judge Doyle, considered that both the issuer and Merril Lynch as managing underwriters were in possession of the material information in question, and thus as both had made optimistic forecasts, both were 'equally obligated to correct the misapprehensions that existed' at the time the plaintiff dealt. However, the Court continued, 'that the duty of Merril Lynch to disclose to the public in these circumstances is less clear than that of Douglas. This is not to say though that no duty existed for Merril Lynch. In view of the demonstrated complicity between the two, and considering the fact that Douglas was a large corporation living in close proximity to the public, and Merril Lynch occupies a similar position and is or should be acutely aware of the consequences of non-disclosure, it cannot be said that it owed no duty to reveal the facts - that this was up to Douglas as principal. Merrill Lynch did after all communicate the facts internally and privately. If its first duty was to Douglas, and we doubt this, it would and should have terminated the relationship' as underwriter.

(103) The unfortunate state that the American law has arrived at is shown by examining the consequences of the Merril Lynch settlement and the statement of policy that they were there required to adhere to with the

present case. Under the statement of policy the firms underwriting department may well have information that it is obliged to keep insulated from the trading and advising departments, thus the firm might well be trading and advising transactions in securities about which its underwriting department has material non-public information about. If the firm discloses this information to all its clients, it will incur liability Rule 10(b)(5), and on the other hand if it does not disclose the information generally to the public, it may well incur civil liability to all those trading in those securities, particularly if it has made selected disclosures or dealt in any way itself. (104) Of course the crucial factor is the degree of disclosure. The alternative, as suggested by Judge Doyle, is for the underwriter caught in such a conflict to resign from the underwriting. But this would not relieve the firm from possession of the inside information, nor the obligations it had assumed with regard to such. Ideally the broker should insist upon timely disclosureand failing this, disclose the information itself. Of course, the broker will not be ina good position to disclose of its own motion and runs the risks of making an incomplete or misleading release in view of its incomplete information. Furthermore, the broker would probably be liable to the corporation for breach of confidentiality, unless there was a federal preemption of the state law.

When the case came before the Court of Appeals for the Tenth Circuit the decision below as to the liability of the issuer was reversed, and thus the question of Merril Lynch's involvement and duties was not before the court. The Court of Appeals was careful to point out that it was not expressing any view on insider trading or the duties of disclosure that Rule 10(b)(5) placed upon the underwriter

and brokers in such situations. (105)

The next case in this developing field, of any significance, was the Commissions administrative proceedings in the Matter of Faberge Inc.
(106) The SEC's staff pursuant to an investigation found that the Executive Vice President of Faberge learning of the companies reduced earnings informed an employee of a securities house, who in turn passed the information on to a securities analyst in Anchor Corporation, which was a registered broker-dealer. Anchor managed a fund holding 100,000 Faberge shares. The analyst contacted the portfolio managers disclosing the information and the fact that it came from the Executive Vice President. The fund immediately started selling off its holdings, but managed only to dispose of 9,800 before the news was released.
The Vice President, in a telephone conversation with an analyst in W.E. Hutton & Company, another brokerage firm, indicated that the corporation had made a loss, and after the conversation the analyst contacted a research analyst at Investors Diversified Services, (I.D.S.) informing him of the 'news' and its source. The Hutton analyst then sent an 'inter-office wire' to all the firms branches, stating that Faberge's management thought that a loss was likely and that the firm recommended immediate liquidation of Faberge holdings prior to the public announcement, and a similar message was put on the Aut-Ex wire to institutional clients. A Hutton branch manager, receiving the wire, immediately contacted a fund manager of another investment bank who sold out also. On receipt of the information an I.D.S. analyst contacted another fund which I.D.S. acted as investment adviser to, and recommended off-loading some 369,800 Faberge shares. The fund manager confirmed the information with the management of Faberge, obtained authorisation

from his superiors and immediately sold out.
A registered firm of broker-dealers, D.J. Greene, were already suspicious about Faberge's financial position and had already started to sell when a partner contacted and obtained the news of the losses, but after this greatly increased the sales drive. Similarly, the president of Spectrum Research, after contacting Faberge's management, liquidated the firms entire holding of Faberge securities. The various defendants made offers of settlement under which the record would show the facts as alleged by the Commission and the defendants would accept the SEC's censure. The Commission accepted this 'to avoid protracted proceedings' although the SEC was at pains to point out the gravity of the violations, and the serious impact that such had on the integrity of the securities markets and investor confidence in such.
(107) Of particular interest is the Commissions observations with regard to Anchor and I.D.S. who has passed on the information to recipients who had not dealt with that firm. The Commission considered that the use of other brokers was irrelevant as to 'hold otherwise would lead to complex reciprocal arrangements and in effect would put a premium on form over substance.' The violation of Rule 10(b)(5) lay in the passing on of the information whether the tipper traded personally or not. The Commission has been alert to similar violations by other professionals engaged in the securities business. (108)

In <u>Shapiro et al v Merril Lynch</u>, a civil action was commenced against Merril Lynch, its employees and also their trading tippees, in the District Court for South New York seeking damages for failure to disclose material inside information that was in their possession relating to earnings forecasts of Douglas Aircraft Corporation.

The case came before District Judge Tenney, on a motion by the defendants for judgement on the pleadings, and on the plaintiff's motion to maintain the action as a class action. (109) During the time that the defendants were in possession of this information they made substantial sales of Douglas securities, on the New York Stock Exchange, and Merril Lynch received commissions and give-ups for executing transactions for clients in these securities. At the same time the plaintiffs made purchases of an unspecified number of shares on the New York Stock Exchange, and thus they contended that the defendants had defrauded them by withholding material inside information which if it had been disclosed would have either discouraged the plaintiffs from purchasing or would have at least reduced the market price of such. Obviously the determination of the plaintiffs motion was dependent upon a finding by the Court that there was a viable course of action disclosed in the pleadings. (110) The learned District Judge in a penetrating discussion of the requirements for liability under Rule 10(b)(5) found 'that the defendants who were trading on an essentially anonymous market wereobligated to disclose the information in their possession to all potential investors trading in the same market including the plaintiffs and members of their proposed class.' (111) The Court considered that the duty was owed to all purchasers in Douglas stock between the time of theviolative transactions and the adequate dissemination of the information. In the result the learned Judge dismissed both motions. (112) and this was affirmed by the Court of Appeals for the Second Circuit. (113) The Court firmly applied and endorsed the 'abstain or disclose' rule laid down by the same Circuit in the Texas Gulf Sulphur case.

In that case it was stated 'anyone in possession of material inside information must either disclose it to the investing public, or if he is disabled from disclosing it ... must abstain from trading in or recommending the securities concerned while such information remains undisclosed.' (114) As in the Texas Gulf case (115) the Circuit reaffirmed the statutory purpose in imposing the obligations, 'it is to protect the investing public and to secure fair dealing in the securities markets by prompting full disclosure of inside information so that an informed judgement can be made by all investors who trade in such markets.' (116) The Court also approved the statement in Radiation Dynamics Inc. v Goldmuntz (117) that the 'essential purpose of Rule 10(b)(5) ... is to prevent corporate insiders and their tippees from taking unfair advantage of the uninformed outsider.'

In Texas Gulf Sulphur, the Court of Appeals remarked that although 'Darke's tippees are not defendants in this action,' and thus 'it was not necessary to decide whether they acted with actual or constructive knowledge that the material information was undisclosed, their conduct was as equally violative of the rule as the conduct of their insider source and ... it certainly could be equally reprehensible.' (118) The Court in the Shapiro decision followed this approach and held the non-trading tippors were liable as well as the tippees. The Court of Appeals rejected, as had District Judge Tenney, the argument of the tippees that they were in no position to disclose the information and should thus be exonerated. The Court considered that if this was the case they should have abstained from trading. Circuit Judge Timbers stated 'Since ... the selling defendants knew, or should have known, of the confidential corporate source of the revised earnings information, and they knew of its non-public nature, they were under

a duty non to trade in Douglas stock without publicly disclosing such information.

Another significant and important series of proceedings, both administrative and court, relevant to this discussion, have arisen from the Lum affair. In SEC v Lum Inc. et al, (119) it was alleged by the Commission that Chasins, the senior executive of Lum Inc. had received earnings estimates which showed a sharp drop when compared with earlier forecasts. Chasins then communicated this information to Simon, a registered representative of Lehman Brothers, who in turn conveyed the information to Sit and Jundt, two senior officers and portfolio managers in Investors Diversified Services, (I.D.S.) The funds managed by I.D.S. immediately sold off Lum securities. The Commission, apart from naming these individuals as defendants, also named Lehman Brothers in the complaint, for failure to adequately supervise its employees and also on the ground of respondant superior. It became apparent that a strange relationship existed between Lums and Simon, and that there was an 'arrangement' under which Simon was given advance access to privileged information, not so that he could pull his large investors out in time, because their respective holdings were too large, but so as not to appear startled by important developments to the clients. Thus Chasins contended his disclosures were in confidence and bona fidi, and certainly not for investment purposes. District Judge Tyler considered that at least in administrative proceedings a negligence standard of responsibility was appropriate, and 'it is evident that Chasin owed a primary or fiduciary duty to the investing public not to abuse his position as an insider in possession of confidential corporate information by disclosing it to someone who might use it for personal purposes. (120) As the disclosure

was not for a corporate purpose, and Chasin had not behaved reasonably, he was properly liable for violating Rule 10(b)(5) . The Court was totally unimpressed by Chasins argument that the information had been disclosed in confidence, as by disclosing it he had placed Simon 'in an untenable position ... if Simon denied that anything was wrong at Lum's he would be misrepresenting the situation; if he disclosed the information, he would be guilty of violating Rule 10(b)(5); if he said nothing, he would either appear to be ignorant or to be hiding something, and in either event would be jeopardising his relationship with his client. 'Thus Chasin would be liable for the foreseeable consequences of his dereliction. Furthermore as the corporation, Lum was in a position to control the activities of its executives, the Court considered that Lum should also be liable for the actions of Chasin, and that the negligence of the executive would be imputed to the corporation. The Commission had not sought to impose liability upon Lehman Brothers as it had the corporation upon the basis of section 20(a) which places liability upon persons in a control relationship to the wrongdoer, (121) but on the basis of vicarious liability. The Court rejected this, and held that section 20(a) was the relevant basis for any imputation of liability. In determining whether the standard of reasonable or goodfaith supervision had been exercised by Lehman Brothers within Section 20(a) the Court was impressed with the fact that Lehman's had forbidden their officers to accept directorships in the issuers of the securities in which they dealt, and had a compliance department charged with general monitoring responsibilities. The Court was unable to suggest any tangible precaution that Lehman Brothers could have taken to have prevented unauthorised casual leaks of information or the personal and informal contacts that its officers

might have. In the result the Court exonerated Lehmans.

The Commission accepted an offer of settlement by I.D.S. under which I.D.S. agreed to the imposition of an injunction without necessarily accepting the allegations of the SEC. Furthermore, under the terms of the settlement I.D.S. had to accept an internal compliance programme, which was annexed to the Courts order. (122)

A particularly significant financial scandal involving considerations germain to this area of the law, is that relating to the Equity Funding Corporation of America, which was allowed to cheat the American public out of some $400,000,000. Although a considerable amount has been written on this affair, attention will here be focused purely upon those aspects relevant to insider and tippee trading. (123) An employee of the Equity Funding Corporation approached the New York Insurance Commissioner's office of Investigation, and the leading analyst in the company's securities, a Mr. Dirks, and gave evidence that the Corporation was engaged in wholesale fraud, with the aid of I.B.M.'s computers. (124) After a six day preliminary investigation, Dirks passed this information and his suspicions on to a number of other analysts and securities houses. After a further eight days he then approached the management of Equity Funding and received enough to confirm his suspicions. After another six days Dirks reported the matter to the SEC's Regional office in Los Angelos, and on the following day to the New York Stock Exchange. The Stock Exchange which had been the last to be notified, suspended trading, but the market price had already dropped $12 during the relevant period.

The next day the SEC suspended all trading, throughout the United States. It was then discovered that the Executive Vice President of Equity Funding had sold 24,475 shares, 80% of his holding, the day before the Stock Exchange suspension; on the same day the President had placed an order to sell his 50,000 shares. Moreover, another firm to which Dirks had made selective disclosures had similarly sold out, whilst others which had not been given this information, while aware of the general rumours, had not sold and even in some cases purchased. Indeed, Hayden Stone Inc. had actually published recommendations for the purchase of Equity Funding stock.

The Commission almost immediately filed a complaint seeking an injunction and ancillary relief, including the appointment of a new board of directors, auditors and the appointment of an internal investigator. (125) In addition some twenty two persons were indicted for conspiracy to defraud and violate a number of provisions in the securities laws, in particular Rule 10(b)(5). (126) The New York Stock Exchange also filed disciplinary charges against Dirks alleging violation of the Exchange's rules and 'just and equitable principles of trade'. (127) Disciplinary charges were also brought against Dirk's firm, for failure to adequately supervise him. (128) In addition the corporation went into bankruptcy.

These proceedings were, however, only the tip of the iceberg; as Bloomenthal describes a host of class actions were brought against Equity Funding Corporation, its insiders and a number of persons and firms. (129) Although certain of the actions have reached settlement, (130) the bulk are still before the courts, and a plan of corporate reorganisation under Chapter X of the Bankruptcy Act is currently before the Court. (131) One case that has been

decided, however, and which is of significance from the point of view of the present discussion of liability of securities professionals under Rule 10(b)(5) is that of Jefferies & Company Inc. v. Arkus-Duntov. (132) Jefferies, a firm of brokers sued the Executive Vice President of Equity Funding Corporation, to rescind sales made by the insider and to enjoin the negotiation of the checks received in connection with the transactions. The defendant denied that he knew of the frauds, at the time of the sale, although he admitted that he knew of certain investigations and the inquiries of Dirks, and guessed that the stock would soon be suspended. District Judge Gurfein thus decided that it was unnecessary to prove that the insider actually knew of the frauds, and the circumstances coupled with his virtual sell out, which was not part of a prior pattern of liquidation, established that he was aware of the true situation. District Judge Gurfein observed that whether the defendant knew of the frauds or not 'he was sufficiently alerted inside the corporation during the week preceeding the sales, of the charges and investigations, and the imminence of suspension of trading to make inside information a factor forbidding the sale by him of his Equity Funding securities. (133) This appears to hold that unsubstantiated rumours are sufficient to be regarded as inside information; although in the present case the rumours turned out to be true, the obvious question arises as to the position of the defendant if the information eventually proved to be false, at least in part. Logically the abuse is the same whether the rumours turn out to be true or false. It is also of some interest that the Court by a novel reasoning process considered that the brokers had standing to sue under Rule 10(b)(5) as when they sought to deliver the securities to

another firm and were met with a refusal to accept delivery, and as they had already issued cheques, to the defendant they were in the position of an enforced purchaser. (134)

Given this attack on tipping and tippee trading both by the SEC and the Courts, the problems facing professionals in the securities industry are of very great dimensions. Furthermore, apart from the fear of administrative action, which is very powerful indeed, in that such can deprive a professional of his career and livlihood, with the relaxation of the privity and causation factors there is the possibility of almost unlimited civil liability. Moreover the uncertainty of their position is all the more because a large part of the law in this area has been the result of settlements which are not presedents and from which there is no appeal. The American Securities Industry has sought to extract itself or at least delimit its burdens under the anti-insider trading law by resort to certain non-legal expedients and procedures.

The most important procedure and solution adopted in the American industry and largely followed in other countries, (135) is that of segregation of functions. This approach has been referred to by a variety of more colourful names such as the 'Chinese Wall', the 'Bamboo Curtain', 'Dont tell your partner technique' and the 'water tight compartments approach' in all, the central notion is the same. That is, those functions that obtain material inside information are to be kept distinct, separate and 'leak proof' from those functions dealing and recommending securities in the same house or firm. (136)

In many securities and investment banking houses the principle of segregation is reinforced by a policy that the firm will not make any recommendations

in securities which it is likely at some time to be in possession of inside information about. The object here, is to avoid the embarassing situation where the firm, although different departments of such, is recommending securities for purchase while possessing information indicating that such would be misguided, or vice versa. To further prevent conflicts certain houses operate a 'restricted list' which is a modified 'no recommendation' approach, and involves the insertion of securities on a list, which are then excluded from the recommendations and investment activities of the firm where a member of the firm receives material non-public information upon such.

It is of some interest to examine the statement of policy that Investors Diversified Services was obliged to accept and impliment under the terms of its settlement with the SEC of its enforcement action against it. The policy makes it very clear that it is completely unlawful to trade or make recommendations on the basis of privileged information, either about the corporate issuer or the market in that security. The policy does indicate certain types of information that should be considered material as a matter of course such as earnings estimates, but apart from this emphasises that the information must be tested against its materiality, public availability and reliability. In paragraph 5 of the policy I.D.S. underlines the fact that 'it is not the policy of I.D.S. to allocate brokerage in consideration of the furnishing of material inside information, and I.D.S. employees in recommending the allocation of brokerage to broker-dealers should not give consideration to any material inside information furnished by any broker-dealer'.

In all cases employees and officers of I.D.S. are forbidden to utilise inside information either personally, for the firm, or for outsiders, unless there is a disclosure of the information and sufficient dissemination. It is made very clear in paragraph 7 that no officer or employee of I.D.S. has any obligation whatsoever to investment companies advised by I.D.S. or individual clients to utilise inside information in violation of the federal law on their behalf. Under the policy a senior Vice President of I.D.S. is charged with the administration of the internal compliance programme and constant surveillance and guidance is placed in the company's law office. (137)

The various procedures set up however, are themselves not free from difficulty. For example, the fact that a particular security, at a sensitive time on the market, has been placed upon a firm 'stop list' , might be very material inside information in itself. Furthermore, this type of approach is of dubious value, purely from the enforcement point of view. Mr. John Wing, the Vice President of A.G. Becker & Co.Inc., at a seminar on compliance programmes, referred to a case where an analyst in his firm had picked up some inside information and reported it to the compliance officer, after already putting the relevant securities up for sale. The compliance officer considered that the information was unuseable and held the sell orders. Evidently another firm had received the same information and were going ahead with a programme of heavy selling. The firms clients merely transferred their accounts and orders to other firms. The original firm was reluctant to approach others to warn them of the danger, and in the result the American Stock Exchange

had to suspend trading, but after substantial profits had been made. (138) Another problem with the 'stop-list' procedure is that it is only of any relevance if applied in advance, and if the firm finds that it has been dealing on advising whilst in possession of inside information 'with one foot in the grave you dont feel too keen on going to the regulators or drawing too much attention to yourself. (139) It would seem to be accepted that if the compliance officer or personnel charged with monitoring these matters, does detect a possible abuse, there is an obligation upon such to report the matter to the regulatory authorities. (140) and thus there is an incentive even inside firms operating compliance procedures to keep the internal-regulators relatively in the dark. (141)

Another problem for securities houses where they are in possession of inside information, is the completely unsolicited enquiry or order. Here the firm is truly in a dilemma and one for which there is no easy solution, whatever course the firm chooses to operate they will be a good candidate for liability to someone or other, or at best stand to losing the client. (142) Furthermore, to afford any hope of protection it is important that there is no violation of the segregation of functions, and here where there are common directors, given the general imputation of knowledge to the corporation or firm at this level, the integrity of the procedure is dubious in the extreme. (143) Nonetheless, such procedures are regarded as the best approach by the industry. (144) The self-regulatory agencies in the United States have also endorsed the segration approach. The New York Stock Exchange in one of its Member Firm Educational Circulars (145) state, 'every director has a fiduciary obligation not to reveal any privileged information

to anyone not authorised to receive it. Not until there is full disclosure of such data ... is a director released from the necessity of keeping information of this character to himself. Any director of a corporation who is a partner, officer or employee of a member firm, should recognise that his first responsibility in this area is to the corporation upon whose board he serves. Thus a member firm director must meticulously avoid any disclosure of inside information to his partners, employees of the firm, his customers or his research or trading departments.' The Circular makes it clear that the same principles should apply even where the member firm officer or employee is not a director but merely an adviser to a company. The Circular adds that 'should any matter require consultation with other personnel of the organisation adequate measures should be taken to guard the confidential nature of the information to prevent its misuse within or outside the member organisation. It has been doubted how well this particular Circular is observed or accepted by the firms. (146) The Stock Exchange has also issued another Circular (147) which was designed to call member firms attention to 'their responsibilities concerning the circulation of unsubstantiated information and situations involving rumours and inside information. 'The New York Stock Exchange fastens upon Rule 435 as the basis of its jurisdiction to regulate this area. The Rule provides,

> 'No member, member organisation or allied member therein, shall circulate in any manner rumours of a sensational character, which might reasonably be expected to affect market conditions on the Exchange. Discussions of unsubstantiated information published by a widely circulated public media is not prohibited when its source

> 'and unsubstantiated nature are also disclosed. Reports shall be promptly made to the exchange of any circumstances which give reason to believe, that any rumour or unsubstantiated information might have been originated or circulated for the purpose of influencing prices in listed securities.'

In the Circular the Stock Exchange emphasised that whilst this did not cover everyone associated with member organisations, the Exchange considers that observance of the provisions of this rule is crucial to the maintenance of good and fair business prectice, as required under Rule 401, and also just and equitable principles of trade. The Circular recommends that member firms delegate to senior officers the duty to receive reports from members and employees of the firm about inside information and rumours, to comply with member firms duty of supervision under Rule 342, and this official would be responsible for informing the Exchange and insuring that there was no misuse of the information in the firm.

In the last couple of years considerable doubt has arisen as to whether the segregation principle is anything more than a 'snare and delusion' from the standpoint of legal liabilities. Even if it is assumed that the principle might serve to establish there was no tipping of inside information or misuse of such for investment purposes, the question arises as to whether it can protect the firm against actions by the firms clients, in that under the general law of broker-client relations in the United States there is an implied obligation on the professional to make full disclosure of all information that he knows or should reasonably know that would materially effect the value of the security in question.

In the case of Black & shearson, Hammill & Company, (148) a senior 'west coast' partner of the large Wall Street firm of Shearson Hammil was a promoter, chief finance officer director, adviser and underwriter of USAMCO. The same partner was also responsible for deciding that the firm would make a market in the company's securities, and underwrite a new issue. He placed a large amount of the new securities with his personal clients and took up 10,000 himself. The firm made what turned out to be false and exaggerated statements about this company as part of the sales programme. The director-partner was aware of these statements, and had in his possession inside information that would have shown such to be false. However, true to the segregation principle he did not disclose this information to those members off the firm making the statements. When he realised that the company was doomed, he immediately off-loaded his own securities and those of his personal clients on inter alia other clients of Shearson Hammill. The plaintiff customers of the firm who had bought the securities brought an action in the California State Courts alleging that by making purchase recommendations whilst the firm was in possession of information that showed such to be erronious, the firm had violated their common law fiduciary duties to them. The firm argued that because of the federal law, despite the accepted fiduciary duties owed by brokers to their clients, the firm was under a higher duty not to disclose the information. The Court considered that the director-partner's silence did not absolve the firm from liability to its customers. In the Courts view the law was that deliberate and possibly negligent non-disclosure of material facts by brokers constituted fraud, the more so where affirmative and false representations had been made. Whilst accepting that the performance of multi-roles in the securities industry had beneficial aspects, the Californian Court stated that the 'oficer-director's conflict in duties is the classic problem

encountered by one who serves two masters. It should not be resolved by weighing the conflicting duties, it should be avoided in advance ... or terminated when it appears.' (149) Thus the customer is not to be deprived of his protection merely because the broker for personal reasons indulges in more than one activity. Martin Lipton and Robert Mazur in their penetrating article on the 'Chinese Wall' consider that the decision on its facts was undoubtedly correct, as the director-partner had not disclosed the information out of any desire to observe segregation, but merely to serve his own and chosen clients personal ends. (150) However the statement of the Court, and the refusal of the state court to accept that the federal law under Rule 10(b)(5) pre-empts the clients remedy goes considerably further than the facts of the case, (151) and it is not without interest that the Court awarded punative damages. Obviously the decision raises profound uncertainties about the integrity of the 'Chinese Wall' solution.

The situation has not been clarified by the recent litigation, very much on the same facts in Second Circuit administering the Federal Law. In Slade v Shearson Hammill & Company, (152) an action was brought against Shearson Hammill on the grounds that as investment banker to Tidal Marine International Corporation, it had come into possession of material adverse information about the issuer, yet nonetheless the firm continued to promote sales of the corporations securities to brokerage customers. Shearson Hammill sought summary dismissal of the action on the grounds that it did not have possession of the information contended, and 'that as a matter of law even if Shearsons corporate finance department had known this non-public information, it was precluded from using it to prevent the solicitation of purchasers by its retail sales force until the information was made public. (153)

District Judge Carter considered that

> 'it is true that an investment banker may not reveal inside information obtained pursuant to a confidential investment banking relationship to its retain customers through its brokerage organisation, but the defendants were wrong to contend that 'an investment banker once it receives adverse inside information, may not prevent its broking organisations from soliciting customers on the basis of public information which, because of the possession of inside information, it knows to be false and misleading.'

In support of this the Court referred to the 'abstain or disclose' rule as laid down in the Texas Gulf Sulphur case. The defendants contended that the application of this rule to brokers would create substantial unfairness to those brokers who happen to chance upon inside information. However, District Judge Carter pointed out that Shearson Hammill had voluntarily entered into transactions involving a conflict of duties and must thus suffer the financial consequences of such. The same judge later retreated from his 'hard line' approach, and in a separate opinion certified for review the case to the Second Circuit, accepting that the Texas Gulf Sulphur test might not always be apposite in the case of brokers. Furthermore, the courts decision had not made any distinction between solicited purchases and unsolicited purchases where the broker was in possession of inside information.

The importance of the case was now becoming appreciated by the securities industry, and even the Financial Times commented that if correct, the decision 'would require a complete restructuring of the securities industry by making it impossible for any broker to also carry out investment banking services. (154)

Before the Court of Appeals for the Second Circuit apart from the parties three separate amicus curiae briefs were submitted, by the SEC and two major investment bankers. In the result, the Second Circuit 'side stepped' the central issue, that is whether there was an obligation on investment bankers and brokers in possession of inside information to disclose such to their clients or generally, or to abstain entirely from conflicting roles, by remanding the case to the District Court for further trial of the facts.

Shearson Hammill contended that as a firm it had made no recommendations about the securities, and this was its practice where there was an investment banking relationship with the issuer in question. The recommendations that had been made were personal ones of the particular salesmen involved, made on the basis of their own knowledge and analysis. It followed that given the 'chinese wall' that the firm had erected, there was no violation of the 'abstain or disclose' rule. Indeed it was argued that the rule as interpreted by the District Court, would result in unduly favouring the clients of the firm by withdrawing them from the market, because of the inside information. Salmon Brothers in an amicus brief thought that Shearson Hammill were misguided in trying to establish that the salesmens recommendations were not properly to be regarded as those of the firm, and thus 'once it is accepted that a salesman's recommendation is in the minds of retail customers, a recommendation by the firm, Shearsons attempted reliance on the Texas Gulf Sulphur principle and the 'Chinese Wall' is seen to be misplaced.' (155) Salmon Brothers thought that the Federal Law could not have been intended to allow the type of fraud in Black v Shearson Hammill with impunity, and the proper solution was merely to prohibit salesmen recommending securities in the firms investment banking clientel.

The problem in the present case was that Shearson Hammill were atrempting to extract their salesmen from the position that they had got into themselves by violating the firms 'no recommendation' policy. The policy was a vital supplement to the 'Chinese Wall'. Salmon Brothers were also mentioned in their brief that to guard against recommendations by salesmen which might run contrary to inside information possessed by the firm, a restricted list technique was used. As no reasons were ever assigned to the inclusion of a security on the list, the investment bankers considered that there was no signalling effect. Salmon Brothers amicus brief also criticised the failure of the District Court to distinguish between solicited and unsolicited orders. Paine Webber in its brief was critical of the views of Salmon Brothers, in that such unduly favoured an investment banking function as against the retail securities house. In essence Paine Webber thought that the primary and sole solution was the erection of a 'Chinese Wall', and that restricted lists and other such expedients could not do otherwise than appear as signals to investors. The firm observed that in its own experience 'the mere act of withdrawing the recommendation will as a practical matter inevitably be taken by the customer as a signal that the firm has come into possession of inside information contrary to the recommendation.'

The commission in its brief largely supported the decision of the District Court, and the notion that Rule 10(b)(5) prohibited any recommendation by a broker which is contrary to material inside information about the security known by him personally or by his firm. The brief suggested that such a conflict problem might be avoided if securities firms required their salesmen to refrain from recommending any security of an investment banking client.[156] In the Commissions view it was the

affirmative representations and recommendations made by Shearson Hammill which created the obligation to disclose. On the other hand the Commission in no way supported the contention that such a view meant that a broker's clients were entitled to the privilege of inside information as against the market. Where the firm got itself into this position then there should be complete disclosure or a willing acceptance of the resultant liability. Where there was no affirmative recommendation then the SEC as did the other amicus curiae briefs, thought that the 'Chinese Wall' would protect the firm from the market at least. With regard to the firms duty to its clients the Commission suggested a species of restricted list procedure which in effect amounts to a no-recommendation procedure. The Commission emphasised that the integrity of such depended however, on the complete non-disclosure of the reasons for including the particular security on the restricted list. Furthermore, as soon as the firm enters into an investment banking relationship with a company as a matter of course, no recommendations should be made even before there is any receipt of privileged information. Thus true to its position in the Merrill Lynch proceedings and the settlement thereof, the Commission has in large measure supported the 'Chinese Wall' approach. The Honourable Ray Garratte, then Chairman of the SEC, at the London Conference on Insider Trading in April 1975 affirmed the Commission's view that the 'Chinese Walls' on the whole worked well and are the best practical solution to a problem that admits of no single universal rule.

Professor Loss would appear to take the same line, although he freely admits that neither the SEC nor indeed the industry has 'fully thought the matter through yet' (157) and the uncertainty has not been lessened by the approach of the Second Circuit,

merely remanding the proceeding back to the District Court; an approach which seems almost destined to end in the usual 'settlement'. Professor Loss has observed that he would doubt whether the 'Chinese Wall' approach would protect a firm with only a couple of partners, as there would in such a case if one partner had inside information, and the other without being told, traded or recommended.' I suppose that we could all agree that probably the information would be imputed to that other partner. (158) It would also seem that consideration of public policy would not allow a securities firm to deal on its own account whilst in possession of privileged information merely be asserting internal segregation. (159) Of course some houses and banks have adopted the safer approach in this uncertain area, of physically separating the investment banking service from the retail service, in separate corporate entities. It is interesting that Professor Loss considers it would be impossible and undesirable to attempt to devise a single codified regulatory approach in this field. (160) The decisions of the Commission in its administrative and enforcement proceedings and the recent civil actions against Shearson Hammill have emphasised that where a duty to disclose arises, then there must be full disclosure to the market and not just clients, and certainly not just selected clients. (161) The Commission has also been keen to place strict responsibilities on professionals engaged in the securities industry to police compliance with the law and fair trading practices by their employees and subordinates. (162) Reference has already been made to the considerations that the Commission, and on occasions the Courts, have paid to the degree of supervision exercised by firms and superiors, where the question of liability has arisen under section 20(a).

It has been stated that 'failure of the controlling person to maintain and diligently enforce a proper system of surveillance and internal supervision and control constitutes participation in the misconduct and the violation will be deemed to have been committed, not only by the controlled person, but also by the controlling person who did not perform his duty to prevent it.' (163) Thus internal compliance procedures have become an important factor in the regulation of the American securities industry.

From the point of view of in-house compliance supervision and in the question of fixing liability under rule 10(b)(5) brokers and investment bankers are placed in an exceedingly difficult position as to how far research staff and analysts should be encouraged or permitted to search for investment information. If the analyst obtains inside information the conflict of interest problem almost inevitably arises, to which as has been seen there is no ready, or at least unexpensive, solution; on the other hand brokers are under a legal liability to properly research and investigate the securities they recommend under the 'shingle' and suitability theories. (164) The dilemma of the analyst is acute, as was seen in the recent proceedings against Bausch and Lamb. An analyst in this firm, as a result of a conversation with the management of a certain issuer, revised his own profit estimation. It was not certain whether the analyst was actually given inside information, and there was every reason to assume that the revision was due to his own perception and skill. The issuer then contacted the analyst and asked him whether he was recommending investment on the basis of his revised forecast, which he denied. The corporation then disclosed to him that the corporation's own revised estimation was largely confirmatory of his own, and

on the following day the corporation published its revised figures. In the interim it was alleged that the analyst passed on his own original estimation to institutional clients, and in consequence of the sales by such an action was brought against the firm for $6,500,000. (165) In addition the SEC brought complaints against the firm, its chairman, the analyst and several recipients of the information. (166) At the time of writing the proceedings have not been concluded, and it would seem that in all probability both actions will be settled. However, no matter what the eventual outcome both emphasise the precarious position of the analysts and the recipients of his information.

With the prospect of almost unlimited civil liability, and strict administrative sanctions overhanging the industry, natural and great concern has been expressed as to the position of analysts. (167) Furthermore, given the fear of a securities law violation, the uncertainty is having a detrimental effect on the flow of corporate information. As Weeks and McCormic write in the Cleveland State Law Review, 'the alternatives open to insiders and the corporate issuers have seemingly polerised themselves, at least in the minds of some businessmen, to either telling nothing to anyone or shouting even the most insignificant bit of corporate news from the proverbial house tops.' (168) Corporations are alert to the dangers of leaking inside information and thus incurring tipper liability, and have thus in certain instances cut the supply of information not specifically mandated by the law or self-regulatory agencies. This is, of course, extremely serious, given the obvious inadequacies of the legal disclosure requirements and the notion, most clearly enounced by Homer Kripke, that disclosure should primarily be directed at the professional. (169)

Indeed, Chairman Cohen of the SEC has been obliged to admit that whilst the Commission opposes selective disclosures, the need and desirability of such in the view of the industry was occasioned by the inadequacies of the legal disclosure regime. (170) However, in view of certain decisions both of the Courts and the SEC, (171) corporations have been most reluctant to facilitate and provide selective interviews and conferences with members of the industry and representatives from the large institutional investors. (172) On the other hand a General Counsel of the SEC, and former Commissioner Phillip Loomis, has stated that 'corporations should continue to meet analysts and answer their questions in an appropriate way'. However, the General Counsel qualified this by the observation that 'your ordinary work as analysts ... does not involve slinking around trying to get this kind of information and get an edge on somebody and make a quick killing on the market.' (173) There can be little doubt that direct contact between management and professionals in the securities industry is highly valued by the securities industry as ameans not only of obtaining up to date information and background data, but also insight as to the significance of trends and developments. There is considerable evidence that securities houses the world over actively encourage their members and employees to develop such contacts and imputs. (174) Both the national securities exchanges (175) and the Commission (176) consider that public corporations should operate an 'open door policy' in their relations with analysts, financial journalists, shareholders and others interested in the company as an investment. Obviously where there is a degree of contact and discussion between corporate insiders

and the industry there are problem areas and nice questions of demarcation. For example in the Bausch and Lamb case, did the analysts own estimation become privileged when he had confirmation of its accuracy from the corporation? (177)

Certainty of the estimation is at least in the nature of inside information, and gives it an additional dimension. General Counsel Loomis, has stated that where the corporation is aware of 'egregious errors' in the estimations of analysts there is desirability in the corporation calling the analysts attention to such. (178) Another problem is the identification of exactly what information an analyst or professional acquires can be properly regarded as of a liability nature. Considerable diversity of opinion here exists. For example the General Counsel to the Commission has said that the test is not one of public dissemination, as much information is not susceptible to this expedient, but 'is this confidential information which the company wouldn't give to a person who came in and asked for it? Are they slipping it to this particular analyst because they expect something in return? (179) The General Counsel also thought that as a basic rule where an analyst stumbled on information he was not necessarily precluded from using it, and this included accidental 'eyesdropping'. (180) On the other hand it was made clear in the Investors Management proceedings that information obtained by industrial espionage and bribery was within the rule's scope. The self-regulatory organisations and the Commission consider that in this area 'prevention is the best cure' and professionals should actively seek to discourage insiders giving them privileged information.

On the other hand the Financial Analysts Federation has advised corporations who consider that they are being unduly pestered by certain analysts to report such to their employers and then, failing correction, the Federation. (181) The New York Stock Exchanges Company Manual provides that 'a company should not give information to one inquirer which it would not give to another. Nor should it reveal information it would not willingly give to the press for publication.' (182) The American Stock Exchanges Company Guide, whilst recommending an open-door policy, states that 'under no circumstances should disclosure of material information or corporate developments be made to an individual or on a selective basis to analysts, stockholders or other persons, unless such information has previously been fully disclosed and disseminated to the public. (183) Empirical evidence and common sense would tend to show that these high precepts are not always followed either by the analyst or broker or the corporation. (184)

The American Financial Analysts Federation mindful of the crushing liability that can befall its members and their firms for violations of the Federal laws in this area have established an Inside Information Committee which has laid down a number of guidelines, which have been accepted by the British Society of Investment Analysts. (185) Whilst the rules emphasise that ideally there should be equal access to information, in practice there can not be equality in the possession and comprehension of such. The guidelines consider that inside information is only that category of information 'which is material, specific, non-public ... received directly from those who obtained information as a result of a

present or past special confidential relationship with the company'. Furthermore, the Federation were concerned that only specific existing facts, events and circumstances should be regarded as inside information; whilst earnings forecasts would be within this category mere beliefs and rumours would not be. The Federation also makes it clear that it considers that the corporation at least an equal responsibility to ensure that there is no leakage of privileged information as analysts and other professionals have in the industry in assessing its nature. Nevertheless, the Federation underlines the fact that it is the duty of the analyst to obtain information and analyse such to assist in the direction of investments. The analyst should not however seek, and should not be given, information that the corporation would not be prepared to publicly release. Thus in the words of Chairman Casey, 'It seems to me this process of private meetings and discussions between corporate officers and analysts is substantially risk free so long as it consists of providing links in a chain of analytical information and public disclosure is made of anything of sharp and immediate significance which is communicated.' ((186) It is interesting that the guidelines consider that Rule 10(b)(5) does not prevent action resulting from the evaluation of non-public information received from an insider, no one part of which is specific material information, even though such a conclusion if communicated by the company would be material. This is aimed at the 'mosiac' notion of materiality, which is of course of particular significance in the case of analysts. It follows from the Federations guidelines and their consultations with various officials and

members of the Commission that where an analyst uses information available to the public to perceive an important corporate development, it would not be unlawful to use the resultant information. For example, in the Texas Gulf Sulphur case, an analyst might reasonably have inferred from reports and accounts disclosing Texas Gulf Sulphur had increased its investments in Canada, that something of significant impact had occurred or was about to occur. (187) To penalise this would be to attack the superior analysis and skill of the individual concerned and would, at a stroke, deprive competent analysis of its rasion d'etre and motivation. The Financial Analysts Federation and the Courts have accepted that the most that can be hoped for is equality, and then only a theoretical equality at that, of access to information. There will obviously be disparities in the interpretation and analysis of such, and indeed in the speed of communication and receipt of such. (188)

Whether the Federations view that 'synthesised' public and inside can when taken as a whole although perhaps bearing all the indica of inside information, nonetheless be used with impunity, is at best doubtful. (189) Whilst James Lorrie in his submission to the Secretary of the Treasury on the development of a public policy for the American securities markets, emphasised that 'the information which analysts seek is not material by any reasonable legal definition of the term, rather they seek small clues which when analysed perceptively and promptly, can be used to predict the future of corporations more completely than a mass of unrefined public information can. He thought that his was essentially information of a 'private nature' and that 'public policy should not generally prohibit exploitation of private information, as this would diminish the quest for such, and thus effect the efficiency of the securities market.' (190) It is likely however, that where

the inside element is of any appreciable independent value in the synthesis, liability could be predicted for utilisation of the resulting conclusion.

Whilst guidelines are of practical value to analysts and other professionals in this area of the law, it is important to bear in mind that such can of their very nature appear as a 'snare' in that they imply a greater degree of certainty than may in fact exist. Both a former General Counsel to the Commission, and a Chairman, have issued this warning, specifically with regard to this particular aspect of Rule 10(b)(5). (191) Profound practical problems arise in the area of fixing civil liability upon analysts who have utilised privileged information for the purposes of their recommendations and analyses. Logically it is difficult to select the appropriate plaintiff absent any insider closer relationship with the issuer than a mere tippee. (192) There is also the problem of identifying the violation and establishing the constituents of liability. (193) As with tipping generally, it will be much harder to identify the persons actually trading on the basis of inside information than in the case of an insider properly so called. Furthermore, there are the multitude of ways, many easily camouflaged in which an analyst or professional could utilise the illicit information.

Another problem area that has arisen in this field, is that of the analyst or professional trading on the basis of his own or his firms recommendations or transactions in particular securities. The leading case on this practice is <u>SEC v Capital Gains Research Bureau</u>, (194) where the Commission brought an action under the Investment Advisers Act 1940, section 206,

to enjoin the defendants from advising clients to purchase securities held by the investment adviser without disclosing the latters proprietary interest. The defendants evidently acquired the securities immediately prior to publication of the recommendations and sold immediately thereafter. Both the District Court and the Court of Appeals for the Second Circuit found that the failure of the adviser to disclose this could not be regarded as a 'fraud or deceit' in the legal sense of the word. The Supreme Court disagreed with this and found liability. The Supreme Court left open the question of whether advisers trading for their own or their firms account in the securities upon which they made recommendations presented such a conflict of interest that it should be specifically outlawed, rather than there be a mere duty to disclose such.[195] Justice Moore in a strong dissenting opinion, considered that 'non-disclosed facts indicate no more than that the respondants personally profited from the foreseeable reaction to sound and impartial advice', and there had been no breach of any fiduciary duty. Justice Moore thought that the position would be different where there had been failure to disclose a bribe made in connection with the recommendation or advice.[196]

A particularly interesting proceeding by the Commission is that in <u>SEC v Campbell</u>.[197] The Commission claimed that a financial analyst and journalist, and his son who was an editor of an investment journal, had purchased securities in advance of favourable recommendations in their articles, on 101 occasions with regard to the father's column, and on 5 occasions with regard

to the son's paper. In at least 58 instances there were price rises of between 80-90% by virtue of the published articles, and in all cases the defendants sold the securities within a week of the publication. The Commission charged the defendants with violating their duty of 'confidence' to readers by not disclosing what they were doing, and furthermore that they had not disclosed the situation to the persons from whom they acquired the securities. The Commission sought an injunction against both the father and the son and disgorgement of their profits. In the result an agreement was reached between the defendants and the SEC under which a 'consent' injunction against further securities law violations was agreed upon, and Campbell paid into court some $.5,000. The Commission had originally claimed $.25,000.(198) The case's importance lies in it being the first proceeding in which the SEC has sought to impose liability for the misuse of 'market information', (199) something which shall be discussed further later on. A number of actions were commenced against Campbell and the newspaper publisher responsible for the publication of the articles, alleging violations of Rule 10(b)(5). (200) The actions were consolidated, and the publishers moved for summary dismissal. The Court of Appeal for the Ninth Circuit, in agreement with the District Court, considered that the appropriate basis for liability with regard to the publisher was section 20(a) and not respondeat superior. This being the case the Courts determined that the publishers should be exonerated for their goodfaith and in the circumstances adequate supervision of Campbell. District Judge McNicolas, for the Court of Appeals, considered that a significantly lesser standard of internal supervision and surveillance was required in newspaper offices than in the case

of brokers and other professionals dealing directly with the public. (201) The appropriate standard in the present case was one 'amounting more nearly to culpability', and as this had not been breached the publishers were entitled to summary judgement. With regard to the individual defendants the case continued, and was at the time of writing still before the courts.

The Commission has sought to tighten up significantly observance of the law in this area by newspapers and their staff. For example, the SEC has laid a complaint against the 'Wall Street Transcript' alleging violations of the federal laws, and in particular failure to register as an investment adviser. (202) Similarly proceedings are pending against Media General Financial Daily. (203) The Commission has also become alert to the dangers of printers and their employees trading on the basis of information in documents they are required to prepare. (204) Attention has also been given to the provision of privileged information to public and financial public relations officers in corporations. (205) The Board of Directors of the Public Relations Society of America in 1963 issued an interpretation on its 1959 Code of Ethics, which, apart from underlining the importance of strict compliance with the federal laws, in Rule 8 expressly forbids the exploitation of inside information, and under Rule 4 places an obligation on the financial public relations officer to ensure prompt disclosure of all material developments. (206)

B. INSTITUTIONAL INVESTORS AS INSIDERS AND TIPPERS

The impact of institutional investors and managed funds in this area of insider and tippee trading, as can be seen from the various cases and administrative proceedings is significant. Funds Managers, as are other professionals in the industry, are under a fiduciary responsibility to the funds and investors that they serve to manage their resources in their best economic interests. Another significant consideration is that with the concentration of control and economic importance of the institutional investors, many are in control and possibly access relationships with the corporations in which they invest.[207] Indeed, in recent years the United States Government and Congress, has, become increasingly concerned about the dimensions of institutional control over corporate issuers.[208] and provisions have been introduced to amend the 1934 Act to require frequent disclosures of portfolio holdings and transactions by institutional investors.[209] There are a number of reasons why private individual shareholders have become suspicious of the power and motives of these large funds, but a significant factor has been the selfish and abusive practices of a number of institutional investors and the consequent repercussions that their actions have had on the integrity, and thus confidence of the market.[210] The SEC has expressed great concern about the disillusionment of the small investor,[211] but at the same time has been unable to prevent the increasing exodus of such. Writing in the Virginia Law Review, James C. Sargent underlines the fact that in large part this disillusionment has resulted from the abuse by the institutions of inside information and[212] furthermore, 'this problem relates to the ability

of large investors to sit down and talk with corporate officials about the corporation', and get the right answers.[213] Indeed investors in mutual funds entrust their capital at least in part on the basis that the fund will have the benefit of superior management and market facilities, and this includes privileged access to information.[214] Given the economic power of the funds and institutional investors they would certainly appear to be in a position more readily enabling them to coax informational details from corporate managements, which are not generally available. Indeed in the Lums Inc. case, the Chief Executive of Lums gave the analyst privileged information so that he could 'smooth out the institutions'.[215] The industry has maintained in the past that 'inside information is difficult to handle, it is over-rated both as to the amount we get and its usefulness. It is not a significant factor in the management of mutual funds.'[216] In particular the industry has pointed to the difficulties of evaluation. However, these are no different than in the case of other tippees, and the funds and institutional investors have the benefit of professional advisers and analysts to assist them in this. Furthermore the industry does not deny that its funds and managers do have contacts with corporate issuers of a dimension that ordinary individual investors do not, and have been accorded preferential access to information on occasions.[217] It is the factor of inequality, and not necessarily the economic advantages that it might provide, that has contributed to the disillusionment of the small investor.[218]

Of course, where the fund does receive privileged information, under the decided cases the duty to onserve the federal law of 'abstain or disclose'

predominates over any fiduciary duty that the fund might have at state law to utilise the information for the maximization of its investors and clients profits. Because the funds are thus in effect locked in, when they receive inside information, there is some evidence that such have placed pressure on corporations to comply with the timely disclosure obligations. As a general rule however, institutional investors both sides of the Atlantic have been conspicuously unconcerned about the management of the corporations in which they choose to invest their large resources. The general approach has been to 'sell out' if the fund's managers are sceptical about the ability and competence of the issuers management, rather than to take a stand against such.[219] Although there have been instances where institutional investors have intervened directly in management matters and thrown their weight against a particular policy[220] the general approach is that epitimised in the words of Angus Murray of the Prudential; 'we prefer backdoor moral pressure and persuasion. It is better than shouting from the rooftops.'[221] However, given the fact that because of the dimensions of their holdings, and increasing pressure from a variety of sources, there is evidence to suggest that institutional investors are becoming far more responsive to the suggestion that they should recognise the management obligations cast upon them by the sheer size of their investment.[222]

In the United Kingdom there has been a particularly interesting development in this area, and this the creation and development of investment Protection Committees by the large institutional investors. It is through these committees that the funds have been able to exert a not inconsiderable

pressure upon corporations, and it is thus of some importance to discuss this in some detail.

The approach of the committees is aptimised in the statement of the Association of Investment Trust Companies, that throughout its history, it has consistently sought 'to establish the rights of shareholders both, in accordance with the rights laid down in the companies documents, and also the right to have a say in the performance of the companies in which they hold shares.' (223) However, none of the committees have been in the forefront of those calling for increased investor protection under the law, as they prefer' to influence the climate of thought rather than seek Government action or legal provisions to remedy abuse.' (224) On occasions the Committees will unite together in one concerted effort against a particular corporation, as was indeed the case in the recent Rank Organisation Affair, (125) there with the express support of Mr. Gordon Richardson the Governor of the Bank of England. (226) Where there is a combined effort on a particular management, it will be most difficult to resist it.

The Association of Investment Trust Companies, and the investment protection committees of the Association of Unit Trusts, the National Association of Pension Funds and the British Insurance Association (227) operate under a cloud or secrecy. Richard Spiegelberg points out in The City Power without Accountability, that what is seen of institutional involvement in corporate management is only the tip of the iceberg, and very much more occurs behind the scenes. (228) Obviously the institutions have an interest in not being seen to 'rock the boat too much' and appear to be concerned about the position of the company as this would directly effect the

market and thus their investments, which are in many instances virtually locked into the company. Thus the institutions and committees have generally assiduously avoided any appearance of 'associating' with management and appearing too deeply involved with management policies.(229) The Committee will, however, in certain circumstances call the assistance of outside bodies, such as the Stock Exchange, and on occasions the Confederation of British Industry. Of particular interest was the pressure that the committees brought to bear on the management of Newman Industries to appoint an outside merchant bank to investigate and report upon certain proposed dealings involving the directors and corporate assets. Many feel, however, that on the whole the investment protection committees have been too prepared not to push a shareholder grievance and attract publicity.(230)

Unfortunately the Association and Investment Protection Committees have not at least publicly sought to make a determined stand against malpractice and insider trading. Indeed in the British Insurance Association's Investment Protection Committee's report in the B.I.A.'s 1974 Annual Report, the Chairman of the Committee, Mr. Peter Bell, specifically denied that the committees and institutions were in any way concerned or responsible for the conduct of companies and their managements. The other Committees have on other occasions made similar statements. The National Association of Pensions Funds which manages over £5,500,000,000 in particular has been criticised for its denial that it has any public responsibility.(231) But in fairness, despite these disclaimers, the committees have nonetheless intervened in practice.(232) Mr. Bayley, the Secretary of the Investment Protection Committee

of the National Association of Pension Funds, informs the present author that if the Committee detected insider trading, which in no case it had, it would report the matter to the trustees of the appropriate fund and to the Stock Exchange or Take-over Panel.(233) In their memorandum of evidence to the Department of Trade and Industry on Company Law Reform in 1973, the National Association of Pension Funds supported any move to curb the use of inside information, but at the same time pointed out the practical difficulties of enforcement. The Investment Protection Committee of the Pension Funds further thought that members of the Stock Exchange should be discouraged from executing orders which they consider might be based upon inside information. In this respect the Committee thought that a mandatory disclosure by brokers of all orders executed ten days or less from the announcement of a merger or takeover at least inhibit abuse, if not actually prevent it completely.(234) Mr. J.W. Melville, The Secretary of the British Insurance Association's investment protection committee, considers that the committee would support the observations of the City Panel on Take-overs and Mergers with regard to inside trading, and would in principle at least support the provisions in the Companies Bill 1973.(235) Both the Association of Investment Trust Companies and the Association of Unit Trusts would take a similar approach.(236)

Whilst Mr. Bayley, the Secretary of the Investment Protection Committee of the National Association of Pension Funds, considers 'that 'funds are exceedingly wary of the possibility of becoming insiders and I view it as negligible,' and thus no special procedures are required.'(237)

On the other hand it would appear that institutional investors are in a position to acquire privileged information, indeed some have representative non-executive directors on the companies in which they are invested. (238) Whilst the institutions and the committees are adamant that they do not use inside information for their own purposes improperly, there aresurprisingly little precautions against possible abuses. The Association of Investment Trust Companies has no written rules of conduct for its members covering the improper use of inside information, although it would appear that there is a well understood rule that improper utilisation of such information would be a serious violation of the principles for which the Association stands for. (239) The same situation pertains with regard to the investment protection committees and membership of the National Association of Pension Funds and British Insurance Association. (240) The Association of Unit Trust managers has, however, got quite an impressive code of conduct. Whilst this code does provide against self dealing, supervision over employees and the preservation of confidentiality, (241) it does not deal with insider trading as such. It should also be noted that even the investment protection committees do not have formalised rules on the improper use of information acquired in furtherence of their functions. Of course, bearing in mind the sort of person usually found on these Committees it is taken, probably with some justification, for granted that at least intentional abuse would be most unlikely. The Association of Investment Trust Companies has observed that 'there has always been since the Association was formed in 1932, an accepted code of conduct that members of committees formed by the Association, do not use any information

of an inside nature which they may gain as members of such a committee.[242] Furthermore, in the case of special committees of the Association where members 'come into possession of confidential information, they are off the market until the scheme or matter is published.' Evidently, this Rule has never been broken in the history of the Association, and it is this trust that enables companies and their advisers to consult the Association fully and freely.'[243]

It is of course ture that in both the United Kingdom and the United States there are laws regulating investment companies and unit trusts, which are of some relevance to the question of insider abuse. However, at least as far as the British law is concerned, there are no provisions specifically relevant to insider trading,[244] and general regulation is outside the scope of this study.

The British Stock Exchange and Take-over Panel have not been slow to acknowledge the dangers in this area however, and have sought to introduce a degree of regulation. Under General Principle 10 of the City Code on Take-overs and Mergers, it is provided that 'during the course of a take-over or merger transaction, or when such is in contemplation, neither the offeror or offeree company, nor any of their respective advisers, shall furnish information to some shareholders which is not available to all shareholders. However, this is qualified by the fact that 'this principle shall not apply to the furnishing of information in confidence by an offeree company to a bona fidi potential offeroe or vice versa, nor to the issue of circulars by members of the Stock Exchange who are associates of any party to the transaction, to their own investment clients provided such issue shall previously have been

approved by the Panel'. Obviously this general Principle aims at equality of information, but a number of problems have arisen in its practical administration and the Panel have promulgated a Practice Note of some interest.(245)

A particular problem has been corporations holding, or approaching the Executive for permission to hold, briefings for selected shareholders, and in particular institutional shareholders. The Panel has expressed some concern about these meetings, as 'whatever the intention at the outset, there is a strong possibility that fresh information will be forthcoming at meetings of shareholders at which directors of companies or their advisers express their views during a takeover or merger'.(246) Apart from the inequality that this would create the information disclosed would not be covered by the standards imposed under Rule 14 of the Code on disclosures. The Panel considers that nonetheless, these meetings and briefings are not 'precluded' provided that certain stipulations are observed. These are, that the meeting should not be held until the offer document has been published, and the offeree company's directors have had an opportunity to publish their views, that all the shareholders should be invited to attend the meeting at least three business days before such is held, although in certain cases of urgency, the Panel in its discretion might accept a press announcement and invitation, that the news media should be invited, and that 'if at the meeting any material new information is forthcoming or significant new opinions expressed, a circular giving details should be sent to shareholders immediately thereafter' or in certain an immediate press announcement made, at the Panel's discretion. In both cases the Practice Note emphasises

that the board should have the same responsibilities for this information imposed under Rule 14, as with other disclosures. If the information disclosed at such a meeting cannot, in accordance with the Take-over Codes criteria be sufficiently substantiated, such as for example a profit forecast, the issuer must formally retract the statement in the release.

The Practice Note also emphasises that the same considerations apply to disclosures by the parties and their associates through the television and radio media. It is emphasised that generally the takeover or merger should not be discussed by the participants through this medium because of the complexity of the issues that will be involved and the kind of presentation that is usually contemplated. Where new information or opinions are however expressed, the Panel again underline the need for circularisation of shareholders, and where necessary a press release.

The Panel does not consider that brokers associated with the participants in a takeover or merger transaction should be prevented from circularising and advising their own investment clients. However, the Practice Note points out that this does not extend to the communication of information which has not been made publicly available 'brokers should bear in mind the essential point that fresh information must not be restricted to a small group. 'Thus such circulars should not contain any statement of fact or opinion derived from information not generally available; in particular profit forecasting, unless and only to the extent that, the offer documents contain forecasts, should normally be avoided'. Furthermore the Practice Note requires the brokers associated status to be specifically disclosed.

Although the Executive can give clearance for issue of such circulars over the telephone, where there is any doubt a draft copy should be supplied in advance, and in all cases a final version must be supplied to the Panel.

The Practice Note and the Code itself is of course, only applicable to take-over and merger transactions and thus in no way effects the ability of corporations to hold selected briefings, as many in fact do, on a variety of other matters. Furthermore, where the meeting is a 'consultation' with such groups, as for instance the investment protection committee's of the institutional investors the application of the Practice Note and Rules are uncertain, even in a take-over situation.(247)

(C) SEGREGATION OF BROKER-DEALER FUNCTIONS ON THE STOCK EXCHANGE

(a) SEGREGATION IN THE UNITED STATES OF AMERICA

Obviously those at the centre of the securities market are in a privileged position with regard to the acquisition of 'market information' and in the ability to act upon such. (248) To appreciate the position of those persons from the standpoint of insider trading regulation, it is of course necessary to consider the role and functions performed by such within the context of the market.

Nonetheless, it is impossible to adequately enter upon a discussion of the structure and organisation of the securities markets in the United States, let alone throughout the world, given the dimensions of this present work. However, it might be illustrative to briefly examine the position of the worlds largest securities exchange, the New York Stock Exchange. (249) The New York Stock Exchange, as does the other American Stock Exchanges operates a 'continuous action market'. (250) This market in 'round lots' for listed securities is not uncontrived because of the presence of the 'specialist.' (251) The Wall Street Journal has graphically stated that 'the specialist is at the guts of the market system,' (252) and Leffler in his leading work on the American Stock exchangeshas stated that 'his work is central to the maintenance of a free and continuous market in the securities in which he acts as specialist'. (253)

A specialist is a member of the Stock Exchange who may act as a broker or a dealer, and thus is vitally different to the British jobber. The specialist in his broker capacity will execute orders on behalf of other broker members of the exchange on a commission basis. In most cases these will be limit orders, (254) and this provides a useful expedient for freeing brokers to trade elsewhere on the market. His second and more complex role is that of dealer or principal for his own account, in the securities for which he keeps a book. In this capacity the specialist buys from the public when there is an offer to sell, but other public bids are not available, and sells to the public when there are no

other sell bids forthcoming from the market. Thus in the words of Leffler 'he maintains a market purchasing stock at a higher price than anyone else is willing to pay at the time, and by selling stock at a lower price than anyone else is willing to take at that time.' (255) The objective of this is to provide a continuous and orderly market with a real degree of fairness, (256) in that at all times he is circumscribed by the rules and regulations of the stock exchange. Whilst performing this role, the specialist, without directly seeking it, earns his profit. 257)

The Congress in the legislative programme of the 'New Deal' were only too well aware of the possibilities of abuse that could resultfrom the combination of broker and dealer functions in the same person. (258) However, the pressure brought to bear by the securities industry was so great that the Congress placed the controversial issue in the hands of the SEC. Under section 11(b) of the 1934 Act, it is provided that national stock exchanges can continue to have odd lot dealers and specialists, but subject to such rules as the Commission may prescribe. However, it is also provided that 'if under the rules and regulations of the Commission a specialist is permitted to act as a dealer, or is, limited to acting as a dealer, such rules and regulations shall restrict his dealings so far as practicable to those reasonably necessary to permit him to maintain a fair and orderly market. 'Moreover, although this is not self-operative in the absence of Commission rules, the section goes on to provide that whether there be rules or not,

> 'It shall be unlawful for a specialist or an official of the Exchange to disclose information in regard to orders placed with such specialist which is not available to all members of the Exchange, to any person other than an official of the Exchange, a representative of the Commission pr a specialist who may be acting for such specialist.'

In addition the Commission is given power to require disclosure to all members of the exchange of all orders placed with specialists, under such rules and regulations

as the Commission may prescribe as necessary or appropriate in the public interest. It is also provided that it is unlawful for a specialist acting as a broker to effect on the exchange any transaction, except upon a market or a limited price order. The Commission under its mandate in Section 11(e) of the Act investigated the feasibility of complete segregation of broker dealer functions, reported in 1936 that the main problems 'grow out of the dealer activities' of specialists. Although a specialist, like any other broker, is not allowed to act as a dealer in a brokerage transaction, at least not without full disclosure and consent, critics of the system maintain that 'this prohibition is insufficient and that the incidence of specialists dealings upon the market in general and upon execution of customers orders in particular, renders it essential that they be prohibited altogether from acting as a broker and dealer.(259) Thus as Loss puts it, the basic issue is whether or not the supposed advantages of the present system justify the possible risks of abuse, generated by a lack of segregation.(260) The economic benefits and the stability argument of the present scheme are open to question, if not doubt.(261) The criticisms made by the Commission of the present system are worthy of attention.

Firstly, the Special Report considered that a specialist had the benefit of special knowledge and superior bargaining power in dealing with the securities in which he kept a book. Apart from not paying commission 'by virtue of his presence on the floor, he is in a position to act more expeditiously than non-members on the basis of information effecting the market ...' (262) Whilst the specialist is tied to his trading post, 'this very lack of mobility keeps him in continuous and intimate contact with the market for the securities which he handles and enables him to become familiar with the effect of periodic seasonal and occasional phenomena, on the prices thereof. 'Moreover, and perhaps most significantly the specialist is in possession of very

material information relevant to the market, by reason of his own dealing intentions and through the orders entrusted to him for execution. The Commission also found that 'frequently a specialist knows, or can ascertain, the source of a large order, particularly if he maintains personal contact with the officials or principal stockholders of corporations in the securities in which he specialises, or if he can identify the brokers acting for them'. The SEC added that whilst it had been contended that the information obtainable from the specialist's book was of little practical assistance as the relevant orders relate to only a small proportion of the market it does allow the specialist to judge market trends, and the relevant figure for market impact will be the floating supply of securities, as the Commission recognised, 'such orders, while not indicative of the trend over long periods of time, do indicate the immediate sensitivity of the market for the stock which the specialist handles'. Moreover, although the specialist is unaware, in theory of already existing orders in the market, in the possession of other specialists, he does occupy a pivitol position in the market and will have knowledge of the sources of orders and the volume or orders. Indeed, the practical advantage gained by professionals with access to the market floor itself, with regard to detecting trends and information, has long been recognised.(263) It has also been said tha t according to the rule that a broker cannot act both as principal and agent in the same transaction, a specialist is bound to execute his customers orders before he can trade for his own account. The impact of this rule is however substantially lessened by the fact that the bulk of the specialists orders will be limited price orders, and thus apart from deals on that particular price, there is no such restraint or qualification.(264) The Commission also found considerable opportunity for specialists to manipulate the market to their own ends.(265)

On the other hand the 1936 Report did acknowledge that there were persuasive economic arguments and those directed towards market stability did not support the

retention of the basic structure. In conclusion the Commission tentatively thought that the best practical expedient would be to require the Stock Exchanges to eliminate the grosser aspects of the multifunction of certain categories of member, through their own rules. The Commission, by the legislative programme of 1941, did however admit that the alleged benefits of the present system had not been proved and that given the essential conflict of interest, legislative segregation might be desirable.[266] The other studies and reports prepared by the SEC have been largely inconclusive on the advantages and detriments of the specialist system.[267] The rules adopted by the Stock Exchanges at the behest of the Commission are aptly illustrated by those of the New York Stock Exchange. Rule 103 of the Rules of the Board of Governors of the New York Stock Exchange provides that if the Exchange finds 'any substantial or continued failure by a specialist to engage in a course of dealings for his own account or assist in the maintenance, so far as is practicable, of a fair and orderly market, the registration of such specialist shall be subject to suspension or cancellation by the Exchange. By virtue of Rule 104 no specialist is to effect on the Exchange any transaction in securities in which he is registered, for any account in which he, his member organisation or any participant therein is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market. The holding of puts, calls and other options in the securities in which he is registered is also prescribed as such transactions, with others, are not considered to be of a nature required in the maintenance of a fair and orderly market.[268] Any participation by the specialist in a pool trading in the securities in which he is registered is also prescribed under Rule 105, and comprehensive records are required to be maintained under the same rule.[269]

Despite the impact of such rules, there have been cases involving specialists where great abuse has been present.

For example, in the matter of Re and Sugrasse, the Commission found that a specialist and his son 'took advantage of their pivotal position as specialists to rig the market for securities in which they were effecting massive illegal distributions on the exchange'.(270) Indeed this case triggered an SEC Staff investigation into the Rules and Regulations of the American Stock Exchange,(271) which was exceedingly critical of the Exchanges supervision over Specialists, and in particular the relationship of many specialists with corporate insiders. In short, the Staff found a serious breakdown in the self-regulatory mechanism.(272) The Commissions special Study of the Securities Markets Markets considered that the conflicts of interest were 'tolerable, but only under a regulatory system which contains effective controls'.(273) The Special Study was also perturbed about the lack of adequate capitalisation that specialists possessed and the possible detrimental effects from the market's standpoint of competition. On the other hand 'the absence of competing specialists makes an effective system of regulation and surveillance particularly important'.(274)

Under the surveillance procedures operated by the New York Stock Exchange specialists are required about eight times a year to submit to the Exchange details of their dealings for unannounced one week periods selected at random by the Exchange. These figures and studies of price continuity, spreads in quotations and depth, are examined carefully by the Exchange to determine the specialists effectiveness in maintaining a fair and orderly market. In addition the New York Stock Exchange and the American Stock Exchange maintain an on-line price surveillance programme based on trading data supplied by the Exchanges computer which are linked to the stock tape.. This programme monitors all trades reported on the tape throughout the market, and when the price movement of a particular security exceeds pre-set norms, the computers automatically alert the surveillance staff. In addition the Floor Officials operate immediate 'on floor' surveillance. (275)

The Special Study of the Securities Markets concluded that on balance the specialist system should be retained, although there is a need to tighten up the degree of self-regulation. After consultation with the Exchanges the SEC promulgated Rule 11(b)-1 which is a set of regulations aimed at providing a comprehensive code, with the self-regulatory rules, for specialists. (276) The rule emphasises that specialists should only deal as principals where such is necessary for the fair and orderly functioning of the market. It is affirmed that Stock Exchanges can register their member as specialists with regard to specific securities, but only if their rules observe a minimum set of safeguards. These are inter alia that such should have an adequate capitalisation, should undertake to deal on his own account to assist in the maintenance of a fair and orderly market, and will indeed only deal as principal in such instances, and that when acting as broker, observe the normal rules relating to brokers. In short, the Commission made the existing rules of the New York Stock Exchange, to which reference has already been made, a national condition for the registration of specialists. The main deficiency prior to the intervention of the SEC was that the Stock Exchange rules were inadequately enforced and administered by the Exchanges. In this respect, of particular interest is Rule 11(b) which provides that the Commission may institute proceedings to require cancellation or suspension of a specialists registration, if he engages in transactions which are not necessary for the preservation of a fair and orderly market. In the words of the Commission this ''places maximum reliance on the self-regulation aspect, by requiring Exchanges Rules to spell out the basic specialist obligations and provides a means for direct enforcement by the Commission when necessary.' (277)

Whilst the present regulatory framework no doubt, goes some considerable way to eradication of abuse, significant potentialities for improper dealings by specialists and their privies, remain. (278)

A specialist still enjoys substantial advantages and privileges in his trading position, and most important is the information that he can glean from his book. Specialists are also likely to have a 'privileged' relationship with the corporate issuers for whose securities they are registered. The New York Stock Exchange's Company Manual (279) emphasises that specialists as they are charged with the maintenance of a fair and orderly market in the company's shares 'must maintain proper liaison with the company's officials. Properly conducted, such liaison could foster a mutually beneficial understanding of the problems encountered by both. 'Thus the specialist will almost inevitably be in a privileged position as to the amount of information that is disclosed concerning the issuer.(280) The Exchange considers that the exchange of information between the specialist and the corporation in whose securities he specialises, is both natural and desirable.(281) The Company's Manual warns, however, that 'there are points beyond which it would be improper for the company to go in giving information to the specialist' and this would comprehend such matters as advance information relating to take-overs and mergers. Information that the Company would give to analysts and investment advisers would be within the vategory of information that the corporation should pass on to the specialist. It is obvious nonetheless, that certain specialists are allowed to have a much greater degree of access, and become in effect insiders.(282) Apart from privileged market information and privileged inside information, the specialists own transactions and intentions with regard to his own account, are material pieces of information.(283)

A learned writer in the New York University Law Review doubts whether self-regulation by the Exchanges will ever be an adequate protection in this particular field, and thus he would advocate the utilisation of Rule 10(b)(5) by both the Commission and the investing public in private actions.(284) In view of the recent decisions there would appear to be little doubt that a

specialist would be liable under Rule 10(b)(5) for the misuse of corporation information. The only real problem is whether this would extend to fix liability upon him, where he used market information, such as that given to him through his 'book' to trade. The Special Study referring to insider trading cases such as in the Matter of Cady Roberts, remarked that 'although the content and quality of floor information... may be different from the information and advantages noted in these cases, the principle remains the same.' (285) The problem with the specialist is that the general 'abstain or disclose' test is inappropriate, as the specialist will not be in a position to effect disclosure, unless of course he alerts the Stock Exchange's stock list department and places pressure on the corporation to disclose material corporate information, and yet on the other hand a specialist cannot abstain from trading on his own account if he is to fulfill his role in maintaining stability continuity in the market. (286) Moreover, a large amount of what might be appropriately called 'market information' might not be susceptible to disclosure. It would seem that the only correct approach affording any degree of certainty, is for the specialist as soon as he comes into possession of inside information, and at least certain types of market information, to alert the Stock Exchange and the Floor Officials.

Associated with the problem of segregation and the specialist is that of the Floor Trader on certain American Stock Exchanges. Floor traders and registered traders are in essence professional investors and speculators who trade on their own account with the full benefits of Exchange membership. (287) The floor traders have no allegiences and no professional responsibilities except those provided for in the Stock Exchange rules. Generally the floor traders will be concerned solely with maximising his own personal profit on the basis of short term speculative trading. Although occasionally such will

assist with the clearance of 'blocks' on the Exchange, and might operate a small brokerage function.' Floor traders may also be used by member firms or individual members to deal on their behalf so as to conceal their identity on the market. The Senate Committee on Stock Exchange Practices pointed out the significant advantages that this type of investor has over other investors in the markets. Namely, by virtue of his access to the Floor of the Exchange ... he has the advantage of instant information concerning the 'technical position of the market.' (288) All the arguments against excessive trading by the specialist for his own account, are applicable with increased force to trading by Floor Traders.(289) The original drafts of the 1934 Act would have completely outlawed floor trading, but in the result the 'butt' was passed to the SEC. Under Section 11(a) the Commission is empowered to regulate and prohibit floor trading by members of Stock Exchanges, for members own or discretionary accounts, to such extent as the Commission may consider is necessary 'for a fair and orderly market' in listed securities.(290) The Commission has expressed concern about the advantages that floor traders and exchange members possess over the public investor.291) The Special Study of the securities Markets considered that Floor Traders possessed at least four significant advantages.' Firstly, rapidity of response to information; secondly, immediate reception of publicly announced information which effects market activity with regard to particular securities; thirdly, contact with other experts and the ability to see what such are doing on the Exchange Floor and fourthly, a feel of the market based on continued presence and observation.(292) Another important factor is that persons on the market can observe transactions occurring some time before they appear on the tape and are publicly disseminated. The Special Study confirmed the general view of the SEC and its staff that Floor Trading was inimical to the public good and should therefore be gradually abolished. Of course the Exchanges had been alert to the criticisms of the practice and had attempted

to regulate at least certain aspects of the advantages that these members possessed. For Example, the Exchanges formulated the 'frozen stock rule' whereby ins and outs were not allowed on the same day. Furthermore, rules were promulgated to prevent members crowding round or dominating a particular trading post.(293) It was open to question however, as to how adequately these rules were observed.(294) In the result the Commission adopted Rule 11a-1(a) which goes a considerable way to eradicating the potential for abuse. This rule provides that no member of a national securities exchange whilst on the floor of such(295) shall initiate directly or indirectly any transaction in any listed security for an account in which that member has an interest or a discretion at the time of the execution. This does not apply in the case of registered specialists or odd lot dealers in the securities in which they are registered, an arbitrage transaction, a stabilising transaction under Rule 10(b)(7) in the case of a distribution of securities, or any ttansaction made with prior approval of the Floor Offficial 'to permit such member to contribute to the maintenance of a fair and orderly market in such securities'.
Under Rule 11a-1(b)7 any transaction effected in conformity with a plan designed to eliminate those floor trading activities which are not beneficial to the market and which has been approved and declared effective by the SEC will be exempted from the prohibition in paragraph (a). Most of the National Exchanges now have 'plans' effective under this provision.(296) The result ofthese provisions and the subsequent implementation of regulatory plans and mechanisms by the various stock exchanges places floor traders like specialists and brokers under something approaching fiduciary standards of behaviour.

Apart from the question of segregation of functions of specialists and floor traders, the question of segregation is of importance throughout the American securities industry. The Report of the Twentieth Century Fund Inc. on Security Markets advocated segregation of brokerage and dealer functions in all cases.(297) The Congress was also

favourably disposed to a legislative provision requiring complete segregation. However, the pressure from the securities industry was so great that it was considered potentially too disruptive to force such a provision through. The Congress instead ordered the SEC to report upon the issue:The Commissions report on the feasibility and Advisability of the Segregation of Dealers and Broker Functions, emphasised the fundamental difference between the duties of persons acting as a broker which were of a fiduciary nature and those of a dealer where there is no such duty. Under the law there is 'considerable latitude' for the exercise of both functions in the same person, although of course, when dealing as a broker it is necessary for full disclosure and the clients consent to be obtained where the broker wishes to trade on his own account with the client. Furthermore, in addition to the general anti-fraud provisions, such as Rule 10(b)(5) and section 17(a) of the 1933 Act, there are a number of specific provisions regulating broker-dealers, particularly those dealing in the over-the-counter market.(298)

The SEC in its Report of 1936 considered that a lack of segregation was (provocative of abuse of the fiduciary relationship inherent in the brokerage function. 'Nonetheless the Commission thought that statutory segregation was premature and impractical.299) The question of segregation in the securities industry has not been raised subsequently in any meaningful form.(300)

(b) SEGREGATION IN THE UNITED KINGDOM

It will be assumed that the reader is conversant with the basic facts of the jobbing system on the British Stock Exchange, and thus attention will only be given to those aspects which are in marked contrast to the American system and are of some interest from the standpoint of insider trading.[301] Under Rule 22(1) of the Rules and Regulations of the Stock Exchange 'every member or applicant for election or re-admission shall declare whether he proposes to act as a broker or jobber or that he is not engaged in active business, and whether he is associated with a firm'. The distinction on the British Exchange between the two functions is of paramount importance.[302] A jobber is a specialised dealer of stocks who buys and sells on his own account, and a broker acts as a mere agent dealing on behalf of another. The Stock Exchange has emphasised that 'in Britain the essential freedom of the market is provided by a group of traders, operating within the market, who stand ready to buy or sell securities as principals at their own risk ... the British Stock Exchange system does not attempt primarily to match up public buyers and sellers, but all transactions are carried out by jobbers, who by their constant readiness to buy or sell for their own account provide a constant flow of business that is needed to ensure freedom of dealing'.[303] Both Brokers and jobbers and their firms are independent of each other, and as no member may perform the same role, both are complimentary to each other.

The two classes of members by tradition deal and negotiate with each other only at arms length, and the prices are made by the jobbers in open competition with other jobbers keeping a book in that particular security.[304] Even when two brokers agree upon a particular transaction or where there are matching orders, the securities are invariably 'put through' a jobber's books, so that 'justice can be seen to have been done'.[305]

Whilst jobbers under Rule 91 of the Stock Exchanges Rules and Regulations are bound to deal with brokers of their Exchange, brokers are not bound to deal on behalf

of his client on the stock exchange, and he is at liberty to go outside the stock exchange. However, except with regard to country brokers and overseas exchanges,[306] the broker may not execute an order with a non-member unless he has previously offered the business on the Exchange on the same terms as those that he proposes to deal with the non-member.[307] As a general rule a broker should only deal off the Exchange where such is to the advantage of his client. A broker may not trade with another broker[308] or have a partner who is a jobber.[309] Furthermore, 'except as a registered option dealer, arbitrage or dual capacity jobber/shunter, no member or authorised clerk can carry on business in the dual capacity of broker and jobber.'[310] Further it should be noted that 'business as brokers and jobbers shall be carried on by firms and corporate members, and therefore no member may carry on business in the capacity of a broker or jobber as a sole trader,[311] and under Rule 84(1) all bargains must be booked in the name of the firm or company.

Of particular interest is rule 27, which provides that any member or candidate for membership of the Exchange, must obtain the consent of the Council of the Stock Exchange, where he wishes to be a principal or employee in any other business, other than that of the Stock Exchange, or a member of the Management and/or the Advisory Board of a Unit Trust, or a shareholder in a management company, except as a minority holder of securities which are dealt in under Rule 163(1),[312] or is in any way interested in any other concern whose business either directly or indirectly, or through a subsidiary includes that of dealing in securities or in acting as an issuing house or merchant banker, except as the holder of a minority of securities permitted to be dealt with under Rule 163(1). It is further provided that for the purposes of determining whether a member wishes to become a principal or employee of any other business, the term principle includes an owner of a business or a partner in a firm, or the beneficial owner either as a sole or majority shareholder in a company, and any shareholding of the wife of the candidate or member

or of the member's partners and their spouses, shall be regarded as that of the member or candidate himself. However, it is provided that the term 'employees' will not include a person merely receiving a directors fee or other kind of fee, but it would comprehend a director holding a service agreement. Under paragraph (2) of this rule an obligation is placed upon the member or candidate to seek the prior consent of the Council where that person's wife wishes to engage in any of the above-mentioned activities.[313] Thus it can be seen that there is a substantial degree of segregation in securities professionals who are members of the Stock Exchange. Of course, those securities dealers who are not members of the Stock Exchange do perform a dual role.

Member firms are prohibited from dealing for most categories of associated members or admitted clerks of another firm without first obtaining that other firm's written consent; and associated members and admitted clerks are under an obligation to disclose their status and the name of their firm to the other firm through which they seek to deal under Rule 84. Recently the scope of this rule has been expanded so as to comprehend principals of member firms, all associated members and clerks and all employees.[314] In the notice adopting this extended rule, it was emphasised that it covers not only dealings through member firms, but also dealings through outside houses. The Council also underlined the responsibility of member firms to ensure that their internal regulations covered such transactions executed through other firms or companies.

The vast majority of British stockbrokers and jobbers possess and administer internal house rules, which are actively encouraged by the Stock Exchange,[315] and also by the City Panel on Takeovers and Mergers.[316] Although the Stock Exchange is not opposed to the publication of these rules,[317] member organisations, as are the American securities houses, are most reluctant to allow public disclosure of such. The degree of investment banking activity and corporate advice of British Stock Exchange member organisations are engaged upon is, of course, in the main significantly less than the extremely large American

securities houses. Thus the Takeover Panels study and guidelines on confidential information is more specifically directed to merchant banks, although it is interesting that two leading stockbroking firms were consulted during its preparation. Whilst it is open to question exactly how far the Panel's guidelines apply to member firms, it would seem that at least the larger organisations consider them of general application.[318]

By way of illustration, Phillips & Drew have rules which inter alia forbid partners and employees, dealing in securities, in any instance to the prejudice of clients, and in particular where the firm possesses confidential information about a particular company to which the firm acts as broker, or is in some other way connected. These rules are incorporated as terms of employment. Furthermore, it is standard practice to quiz any order from a known insider which appears at all suspicious.[319] Similar rules are found in most firms and member organisations.[320] Furthermore, asa basic proposition, most firms require their members and employees to deal only through the firm and thus subject themselves to internal supervision. Under the new Rule 84(2)d, it is provided that

> 'a firm shall make such provisions in its internal regulations as will ensure that each of its members, admitted clerks or employees, is under an obligation to have obtained his firm's approval before instructing any other firm to deal for him, or for any unlisted company in which he has an interest; and that each employee is under an obligation to disclose the name of his own firm to any other firm to which he proposes to give dealing instructions.'

Not all member organisations have formalised and written internal procedures, and among such are certain of the more prestigious firms.[321] Whilst this is justified by the member organisation by reference to flexibility, many including the Takeover Panel[322] consider that this sacrifices the necessary degree of certainty and the educative effect of such on employees and others.[323] There are, however, a significant number of organisations which are less than enthusiastic for this degree of

self-regulation, particularly in regard to insider trading.[324]

A very important role performed by a number of brokers is that of acting as broker to listed companies.[325] Brokers performing this function will, on a number of occasions, be in possession of privileged information, even though most companies are wary about exactly how much access they afford, because of the obvious possibility that the broker might utilise the information for investment purposes, unconnected with a valid corporate purpose.[326] Somewhat paradoxically company brokers are also regarded with some circumspection by other professionals and investors because 'they have an axe to grind with their company clients' and thus might not be sufficiently objective, or indeed reliable.[327] Thus many member organisations expressly try to avoid becoming too closely identified with a particular corporate issuer, and by and large this function is not as remunerative as it might at first appear.

With regard to conferences with corporate managements, and visits, the general approach would seem to be that where the interview is with the broker qua a stockbroker, then 'everything you are told or shown is fair game for investment and recommendation.'[328] Whilst it would seem that most brokers would not violate an express confidence, many would feel at perfect liberty to utilise inferences and indications which might in truth amount to the same thing.

It is also of interest that at least one very experienced city editor considers that there is a substantial degree of abuse in Britain by members of stockbroking firms of market information. Mr. Richard Lamb, Editor of the City Press, had informed the present author that in his opinion a number of senior members and officers of stockbroking firms trade in significant proportions in advance and on the basis of market impact of their firms recommendations and analysis.[329]

Because of a number of factors the jobbing section of Stock Exchange membership has greatly contracted in recent years, which has, of course, had an impact upon competition and the capacity of the market.[330] The market has become increasingly less able to deal with the size and dimensions

of institutional trading, on terms that are readily acceptable to the institutions.[331] As the Investors Chronicle aptly states, 'the fundamental trouble is that the jobbing system arose to meet the needs of private investors dealing in small and often untidy amounts. The different needs of the institutions who now dominate the market are being met by the brokers - but not the jobbers.[332] Furthermore, the smaller or more marginal the market, the less realistic is the valuation placed on shares, particularly inactive stocks.[333] All this has tended to focus an increasing amount of attention on the British over-the-counter markets, as such they are.

There are, of course, a number of public companies which, either by choice or circumstances, have not thought it necessary to seek a listing on the Stock Exchange. With the recent contractions and vissisitudes of the Stock Exchange market, there would appear to be an evergrowing number of companies seeking finance outside the Stock Exchange, often with the active support of investment bankers such as M.J.H. Nightingale & Company, who act as market makers on the North American pattern.[334] Securities dealers who are not members of a recognised Stock Exchange, or recognised Association of Securities dealers, under Section 1 of the Prevention of Frauds (Investments) Act 1958 and who has been granted a licence to deal in securities by the Department of Trade, are at liberty to deal in any securities within the United Kingdom as either principal or agent. The various recognised Associations of Securities Dealers also allow their membership to trade in all securities, both listed and unlisted. Members of the Stock Exchange under Rule 163(2) are at liberty to deal in unlisted securities provided they obtain the consent of the Stock Exchange Council.[335] Until comparatively recently, the over-the-counter market was by comparison with the London and Provincial Stock Exchanges insignificant. With the apparent rise of the over-the-counter market the Stock Exchange has naturally become very concerned, and has fastened upon the argument that such will fragment the securities market

and thus create severe regulatory problems.[336] The Federation Internationale des Bourses de Valeurs, at a conference in Madrid in 1973, expressed concern about fragmentation of the markets, and passed a motion deploring it. Suggestions have been made for the development of an European over-the-counter market, which the Stock Exchange has similarly deplored and castigated as irresponsible and, if accepted, necessitating the establishment of a European Securities Exchange Commission.[337]

Perhaps the most significant development in this area has been the establishment of the Automated Real-Time Investments Exchange Ltd. or ARIEL. This organisation was established and largely financed by the Accepting Houses Committee who were anxious to devise a more satisfactory and indeed less expensive means of dealing in large blocks of securities than through the medium of the Stock Exchange. The system was based on the New York Instinet system, with certain important modifications.[338] The Stock Exchange obviously concerned about the implications of the creation of such a system, after extended negotiations, had an offer to purchase the system itself, turned down flatly by the Accepting Houses Committee.[339] The Bank of England, rather lukewarm about the creation of ARIEL, decided not to allow trading of gilt-edged securities on the system.[340] The Stock Exchange Council has refused to allow brokerage and jobbing firms to use it. The Council has stated that 'at present it is concerned with principles', and on this basis the Stock Exchange opposed the establishment of ARIEL on three grounds. Firstly, they considered that the fairness and integrity of the securities markets in the United Kingdom was based on the segregation of broker and dealer functions. Secondly, the fragmentalisation of the securities markets with its adverse effect on liquidity would upset the price mechanism. Thirdly, the fragmentation of the securities markets would create problems with regard to supervision. On this last point the Council of the Stock Exchange considered that ARIEL had no sanction over subscribers, and as the system could comprehend unlisted issuers, there may well be little supervision of the companies having securities

traded on the system.(341) The Stock Exchange has also disallowed the ARIEL system the use of the important Exchange Telegraph Financial News Service tape, and attempted to adjust its commission rates so as to lessen the appeal of the new system. On the other hand ARIEL has declared that 'tough commercial competition' will be brought to bear.(342) Given the significance of the ARIEL system and the fact that, at least the Managing Director of the system considers that 'the market of the future may be an international communications network ... and not a single geographical location or trading floor, or even a series of trading exchanges linked together by a communications network,' (343) it is necessary to examine the present system in some little detail.(344)

In the words of the ARIEL management, ARIEL 'enables subscribing institutions to deal in stocks and shares directly and anonymously with each other ... institutions can deal more cheaply because transaction fees are lower than comparative stock exchange commissions and no jobber's turn is incurred.' (345) Each subscriber is connected by a 'terminal' which consists of a teleprinter screen, a keyboard, and a printer, to the central computer situated at ARIEL's head office. All messages and communications appear on the screen and are also printed out in permanentform. If a dealer in a subscribing institution wants to purchase 10,000 I.C.I. shares at 217p. he types out these details, suitably codified into recognised abbreviations, after activating his terminal by 'signing in' through a secret code. After these details he adds the word 'buy'. This will be immediately transmitted to the screens and printers of all other subscribers, and also stored in the central computer which in effect keeps 'a book' on each security in the system. If a subscriber wishes to sell he can respond by typing out the same details, but with the sufffice 'sell'. This will similarly appear on all terminals activated. The central computer will then automatically match the two transactions and prepare a contract note. The system does allow dealers to negotiate anonymously with each other by transmitting varying bids to sell or buy, and a subscriber

who wishes to deal discreetly may sign-in and scan the records of bids stored in the central computer, without broadcasting its interest in the particular security. Unaccepted bids are automatically erased after a specific period of time.

The shareholders of the system, which are the members of the Accepting Houses Committee, and the management are diplomatic as to the aspirations of ARIEL. The Managing Director, Colin Leach, has pointed out on a number of occasions that it is only contemplated that the system will take some 10% of institutional business, which is about 4.5% of Stock Exchange business, and that the institutions will still require the analysis and research facilities provided by Stock Exchange member organisations.(346) Furthermore, a recent survey of ARIEL transaction prices shows that most deals were executed at the middle market price on the Stock Exchange so that it would seem that the Stock Exchange is still important for determining prices.(347)

It should also be noted that it is possible to retrieve from the central computers information on any security in the system, such as the current price range of both buyers and sellers, the aggregate volume and price range of bargains made in the current month and preceeding month, and the size and price of the last four bargains executed on the system. At present ARIEL trades almost exclusively in listed securities of some standing, but it is understood that if a sufficient demand among the subscribers to introduce unlisted securities to the system was apparent, then ARIEL would be prepared to do this. The Managing Director made it clear that there is no question of ARIEL attempting to impose any additional disclosure requirements on such issuers, and in any case the system was not a public market, but one essentially of professional investors.(348) Moreover, as the number of subscribers is relatively small, amounting in all to about 70, there exists a degree of confidence and trust among the dealers not generally found on markets of this nature.

The management of ARIEL are sceptical and critical of the Stock Exchange's assertions that the system fragmentalises the present securities market. Certainly the present

indications suggest that the amount of transactions that ARIEL has attracted from the Stock Exchange would hardly justify the Council's allegations.[349] Indeed, Mr. Leach, the Managing Director of ARIEL, considers that the system improves the self-regulatory scheme, in that there is a greater degree of competition, now transactions that would have been conducted outside a formalised market are passed through the ARIEL system, and also all transactions on the system are recorded, printed out, and then at a later date, transferred to microfiche. This last factor would seem to be of some significance as the Stock Exchange does not provide this facility under its current procedures, and evidently ARIEL has been able on occasions to supply important transactional data to the City Panel on Takeovers and Mergers.

Whilst the Managing Director of ARIEL informs the present author that it would, of course, be feasible to manipulate the automated market, there has been no evidence of such or any other fraud.[350]

The staff of ARIEL is surprisingly small numbering only twelve persons, six of whom are technically qualified. Out of this staff, three persons, currently a computer expert, an ex-jobber and a technical assistant, operate the transaction room. This room is inter alia responsible for the market surveillance function. Here the screens are, at least in theory, continually watched, and there is always the facility of reproducing communications from the computer records or compiled computer printouts. Whilst the Managing Director considers that it would be technically quite feasible to introduce an automated stock-watch programme on the American pattern; with built-in trading parameters, there would be very great practical problems in determining what such should be, given the shapes and volume of trades and the nature of the market. Furthermore, the Stock Exchange, as has already been pointed out, will not allow the ARIEL system access to Stock Exchange prices, which could naturally be of great utility here. Thus given these considerations, and the relatively low transactional turnover, the management does not at the present consider there is any justifiable alternative to the current approach.

It is also of interest that the Managing Director does not contemplate any significant increases in staffing in the foreseeable future. The system has obvious and close connections with the Acceptinh Houses Committee, and has co-operated with the Takeover Panel. Where the Stock Exchange suspends trading in a Particular security, the 'ARIEL'system will follow suit provided that it is aware of the hold. Generally the system has to rely upon one of its subscribers to alert the transaction room. Certainly in the end the management would hear of the hold, and if a subscriber had dealt during the period where trading had been suspended in a listed security, ARIEL would investigate the circumstances, and would probably apply 'pressure' on the institution concerned to make an offer of recission.(351)

As the ARIEL system is still comparatively small it is possible for the transaction room to adequately survey the trading and the management does exercise a considerable amount of caution and restraint about admitting new subscribers to the system. There have been occasions where applications have been refused. The system also places considerable emphasis on the fact that all subscribers admitted to trading on ARIEL must have a reasonably large indemnity policy, covering a multitude of potential problems. This itself serves to delimit the number and type of applications, through both the availability and expense of insurance. A significant surveillance function is also provided by the fact that subscribers are keen to identify and alert the transactions room as to the presence of suspicious trading.(352)

Under the influence of the Accepting Houses Committee ARIEL has adopted strict internal codes of conduct for its staff members. These provide, inter alia that a member of the staff can dealin any shares only with the advance permission of a director, and violation of this rule would result in instant dismissal. The Directors however, simply rely upon each others integrity. It should be pointed out that apart from the Managing Director, the other directors are nominees of the shareholders, that is the merchant banks. The Managing Director has informed the present author that there has been a problem with the leakage of information

on ARIEL transactions and prices [353] to the Stock Exchange in particular. By scanning the records in the Central Computers, it was discovered that whenever the management was informed about a possible leakage of information, a particular institution had at about the same time pressed the 'quote' button on its terminal which provided details of all bids and deals in the particular security concerned. Of course, whilst the various institutions trade in complete anonymity, the system can always identify such through their code numbers. In this particular instance the Chairman of the institution concerned was interviewed, and it was found that two dealers had been passing on this information to a stockbroker, who had utilised this 'market information' on the Exchange Floor. In the result, the two dealers were dismissed, and the institution came out of the system. Mr. Colin Leach, the Managing Director has pointed out that this particular problem could and should be eliminated by a greater degree of co-operation by the Stock Exchange Council. He pointed out that the Instinet system has the New York Stock Exchange Tape as its basis and the floor and automated markets functions in close co-operation. [354]
Whilst the management of ARIEL have diplomatically adopted a low profile, there are plans, admittedly tentative, for the system to link up with the Instinet system, and perhaps in the future an European system might become practically and politically feasible.

Whilst it is not possible to enter upon an extended discussion of the position of brokers under the common law, it is perhaps worth briefly mentioning those aspects which are of particular relevance to the question of insider trading and its regulation. Of course, the position of a stockbroker is similar to that of any other agent in law. [355] There is no doubt that a broker is in the position of a fiduciary and, as such, is not allowed to make a secret profit. [356] Brokers perform an important role in providing investment advice for clients, which range from corporations and institutions to individual clients. [357] Obviously where a broker is in possession of material inside information and is either asked or is obligated to provide investment advice a conflict of duties arises, as we have already seen in the context of Rule 10(b)(5). [358] Whilst brokers are

not bound to volunteer investment advice to every client who issues an unequivocal instruction,[359] there is a shadowy border line; not so firm as the American suitability rules, where a broker is apparently under an obligation to proffer his opinion. Where the client expressly or impliedly requests the brokers advice, there is no doubt of his responsibility to so comply. Where the broker does give advice, he is held to the fiduciary duty of ensuring that it is 'honest, clear and in the best interests of the client,'[360] the duty in the law of negligence mandating reasonable care,[361] and possibly also a contractual duty of care.[362]

It is not without interest that Cooper and Cridlan in their text on the Law and Procedure of the Stock Exchange, write that 'where a broker has access to privileged information about a company, and is aware of circumstances which will effect the value of its securities, he must not allow that knowledge to operate to the disadvantage of his client.'[363] Given this, and the duty to use reasonable care in the provision of advice and protection of the clients financial interests, it would seem that the British law is much the same as the state law in the United States which would appear to recognise the duty of a person in a fiduciary position to utilise inside information for the best investment interests of his clients, irrespective of other equal duties that he might at the same time owe. Where the broker is asked for his advice, or exercises the discretion of management, the broker would appear to be under a duty, in the United Kingdom at least, to utilise any and all information in his possession with a degree of reasonable care in the advancement of the clients best interests. Indeed the Head of the Public Relations Department of the Stock Exchange informs the present author that brokers have received letterd from clients and their solicitors on occasions threatening action because the broker had not disclosed inside information in his possession or which he should reasonably have had access to.[364]

Thus it arguable that even in the case of unequivocal instructions a broker, at least as a matter of practice and business sense, would be wise to warn the client of the information he possesses. Of course, it would not be necessary either in law or in practice to communicate the entirity of the information, although it would seem that reasonable care should be exercised both in the provision and accuracy of the information, and thus the more the broker discloses, the better are his chances of avoiding liability by moving the burden of care and reasonableness on to the client.(365)

From the brokers fiduciary position alone it would seem that there is a duty to give information and advice, or both with diligence and in absolute good faith.(366) In the leading case of Nocton v Lord Ashburton, Lord Dunedin stated that 'a fiduciary position imposes upon the fiduciary the duty of making a full and not a misleading disclosure of facts known to him when advising his client.'(367) A violation of this standard, whilst not founding liability at law in deceit for fraud will in every instance constitute fraud in equity providing compensation and possibly recission.(368) Indeed in certain circumstances the fiduciary duty will be parallel to the contractual duty of care, founding alternative bases of liability. Thus it would appear that under this principle a stockbroker would be under a fiduciary responsibility to make adequate disclosures of material information in his possession or which he should have reasonably acquired. Indeed as Lord Shaw of Dunfermline emphasised, once a fiduciary relationship has been found, 'it becomes manifest that the liability of an adviser upon whom rests the duty of doing things or making statements by which the other is guided or upon which the other justly relies, can and does arise irrespective of whether the information and advice given, have been tendered innocently or with a fraudulent intent'(369)

Whilst in recent years the propriety of brokers and other professionals utilising privileged information for investment purposes has been increasingly questioned,

and now it could hardly be doubted that insider trading is regarded as unethical by the majority of responsible opinion, it would seem that in the absence of an express provision in a legislative enactment forbidding the misuse of such information, those in a fiduciary position are under an obligation to utilise that information for the benefit of their beneficaries.[370] In England there is no higher Federal Law preempting this duty.

Obviously where brokers act as underwriters or perform an investment banking function, as well as act as stock-brokers, the question arises as to whom, in the event of a conflict, does the broker owe the highest duty. In the present discussion this resolves itself into the proposition of whether the broker should betray his confidence to a corporate client by disclosing to his other clients inside information, or whether he should preserve the corporation's confidentiality at the expense of the investment clients.

It was laid down very early on that an agent or fiduciary of one person could not take it on himself to become an agent or fiduciary of another, given a possible conflict of interest. Comparatively recently, Lord Hammworth M.R. in Fulwood v. Hurley stated 'if and so long as the agent is the agent of one party he cannot engage to become the agent of another principal without the leave of the first principal with whom he has originally established his agency.'[371] Although there are obvious differences between the position and function of an insurance broker[372] and a stockbroker, there are nonetheless significant similarities, and it is of advantage to briefly examine two recent cases involving almost identical conflicts of duties as those presently discussed.

A particularly troublesome problem has been the practice of insurance brokers to act on behalf of underwriters for the communication of information between such and the assessors, where a claim is made by the insured against the underwriters. Thus in effect the broker is acting for two principles, the underwriters and the clients, both with conflicting interests with regard to this information.

In Anglo-African Merchants Ltd. v. Bayley[373] Megaw J. condemned the practice, but as this condemnation was only obiter and the practice was widespread, it continued largely unchecked. In North and South Trust Company v. Berkeley,[374] the legality of the practice was firmly before Donaldson J. who expressed surprise that its propriety had not been questioned before the decision of Megaw J. In this case the insured demanded delivery up of the assessors report from the broker, and the underwriter sought an injunction to prevent the brokers complying with this demand, claiming that it was privileged. Donaldson J. emphasising that 'the propriety of this practice is fundamental to the decision on the issues' and that the statement was ratio stated that it was 'wholly unreasonable' and thus although admittedly widespread, not capable of being regarded as a usage. The underwriters whilst acknowledging that there was a possibility of abuse, stated that 'part of the training of the broker is to act properly in the dual capacity, and there was no occasion of which they had heard of where brokers had used their dual position improperly.'[375] However, the Court doubted this, and commented 'how do you train anyone to act properly in such a situation? What course of action can possibly be adopted which does not involve some breach of the duty to one principal or the other? I yield to no one in my admiration for the skill and honesty of the City, but neither skill nor honesty can reconcile the irreconcilable.'[376] Donaldson J. thought that the only reason that the practice had endured so long, was the integrity of the brokers and thus the resultant lack of publicity, and thus the ignorance of the fact that the practice existed. There could be no doubt that the broker was the agent of the insured with regard to everything done 'in consequence of effecting the policy' and as such agent, the broker has a general duty to advise and assist the insured in relation to claims, and in that connection to disclose to the insured all relevant information that he may be able lawfully to disclose. Donaldson J. accepted that if the broker would otherwise

be entitled or obliged to give the insured the information which is recorded in writing, it is irrelevant that if the documents were in the possession of the underwriter they would be privileged from disclosure. Furthermore, the Court accepted the proposition that an agent could not, without fully informing and obtaining the consent of his principal, place himself in a position where he owes a duty to another which is inconsistent with his duty to the principal, 'if he does so, he cannot say to his principal, I have not discharged my duty to you because I owe a duty to another'.(377) Donaldson J. pointed out that if an agent does place himself in such a position his action is not a nullity - 'it is to be accepted as a fact, with all the special consequences flowing from its unlawful nature.' Thus this fact cannot provide him with a defence to a claim by the true principal 'for compensation for loss resulting from the agents inability due to the conflict of duties, fully to discharge his duty to that principal.' Furthermore, the learned judge considered that 'it may provide the true principal with a cause of action against the agent for an account and payment over of any benefits which the agent has received in the course of the unlawful agency.' The Court continued that 'If the agent had been employed to make a contract between his true principal and another for whom he is unlawfully also acting as agent, the true principal cannot avoid the resulting contract.' If that other principal knew of the agency and the transaction resulted in a sale, the court will, as between the two principals, presume that the other principal would have bought at a higher price or would have sold at a lower price to the extent of the payment which he unlawfully made to the agent.'(378)

The next step in the Courts decision is one of critical importance, yet one upon which no authority was cited. Donaldson J. stated as a proposition that 'contained much that was sound'; 'if X. a third party, knowing that A. is the agent of P. the principal, enters into an agreement

with A. involving duties which are inconsistent with those owed to P. then in the absence of the fully informed consent of P. X. acts at his peril,'[379] and 'where there is any resulting conflict between X's interests and P's interests, the law will prefer those of P.' Thus the law will give priority to the responsibilities of the first agency, and thus the principal who entered into the agency or fiduciary relationship with the broker first in time will have priority. Therefore if a person wished to have M as a broker, he should realise that M. is the broker already to XYZ company, and thus any confidential information that might be within the responsibility of a fiduciary to utilise for the best investment interests of a client, that M. learns through his relationship with XYZ company will not be available, as this relationship is pre-existing. The position is not as clear cut as it might seem however, as on this analysis, if the broker M. already had investment clients when it entered its relationship with XYZ company, it would seem that the company is 'at its peril' with regard to these earlier agencies. This is, of course, highly unsatisfactory and whilst perhaps logical, most undesirable. The priority rule only operates satisfactorily where there are only two principals and not where there are multiples. It is not certain to what extent Donaldson J. considered this rule was applicable, and it may be that he thought its correct application was confined to the avoiding of any resulting contracts and accounting for commissions paid to agents.[380]

Perhaps a preferable approach would be that suggested by Donaldson J. that 'by treating the common knowledge of the underwriter and the broker that one could not lawfully give and the other could not lawfully receive the information as constituting an implied waiver of the implied seal of confidentiality with which the information is impressed'. In the present case this knowledge could not be imputed to the underwriters and brokers, as neither knew that as a matter of law the arrangement was improper. This is open to question however, as it is a fundamental maxim that

ignorance of the law is no excuse, and the strong criticism of Megaw J. in the previous decision has already been alluded to. Thus if this approach was accepted as the proper one, since the present determinative condemnation of a broker acting in such a dual capacity it would appear that anyone entering into an agreement which might in certain respects be contradictory in its proper performance to one already existing and owed to another person, impliedly, as a matter of law, waives the performance of those obligations which are or might be so contradictory. Indeed in the case of a stockbroker, companies will be aware that there is a strong possibility that information passed to such will be utilised for investment purposes. However, an 'all or nothing' application of this rule could have undesired results as, if it was taken that in such a case all obligations of confidentiality were impliedly waived, candour, in important matters such as underwritings and take-overs, might be substantially impaired.

The Court would not accept the contention, advanced by the plaintiff that 'if knowing of A's agency for P. X passes information and documents to A. relevant to matters which are the subject of that agency, X cannot complain, if A. complies with his duty to P. to pass on the information or to show those documents to P. however confidential that information or those documents might otherwise be, unless X. has first obtained the fully informed consent of P. to A's receiving that information or those documents exclusively on behalf of X.' (381) Donaldson J. considered that this was supported neither by reason or authority, and that 'it assumes that it is the duty of the agent to pass on to the principal information which he would not have obtained save on terms that it would be kept confidential from his principal.' (382) The Court considered that the information could not be thought of as a benefit for which the agent was accountable, (383) and that the contention of the plaintiffs that the information in the assessors report was 'property' wrongfully acquired in the service of the plaintiff was fallacious. With some significance Donaldson J. doubted whether information could be considered property

in this context, and even if it could, it had not been acquired by the broker, it was merely in their possession. However, it is difficult to see how one can have possession or custody of information without acquiring such, unless Donaldson J. was importing some absorption or comprehension test. In any case the Court considered that even if the information had been acquired, it had not been in the service of the original principal but the underwriters. Whether this is significant is open to question, as Donaldson J. had already held that this was wrongful, and that the rights of the second principal were inferior to those of the first.

The Court described the fallacy underlying the plaintiff's argument as that the brokers in acting for the defendants had undertaken duties that inhibited the proper performance of their duties towards the plaintiffs, but in so far as they acted for the defendants they were not acting in discharge of any duty towards the plaintiff. The plaintiffs could legitimately complain and sue for damages 'if and to the extent that the partial dislodgement of their hat has caused them loss or damage. But what the plaintiffs ask on these proceedings is to be allowed to see 'what the brokers were keeping in their performance of their unlawful duty to the underwriters. Donaldson J. held that 'there is no warrant for this.' Kay and Yates commenting in the Modern Law Review on the decision, point out however, that this reasoning may not be applicable to the facts as the plaintiffs claim 'arises not from the discharging of the duty owed to them, but from the breach of such a duty - a breach of which the defendants had knowledge at the time when the information was procurred for them by the brokers.'

It should be remembered that as Donaldson J. himself pointed out, in the future the decision would be different, as he had determined in emphatic language that the practice was unlawful. Thus 'presumably future plaintiffs should at least obtain their declarations on the basis of the agent as a constructive trustee of the information.' Even if the information is not regarded as property, there seems no reason to suppose that the equity which restrains the

transmission of confidential information in breach of a confidential relationship, will not equally compel disclosure where the information has been obtained in breach of the duty arising from such a relationship.' (384) There has been no appeal from this decision, but after the obiter dicta of Megaw J. in Anglo-African Merchants Ltd. v. Bayley, Lloyds set up a special committee to examine the problem, and subsequent to a report by this committee, proceedures have been changed. (385) The implications of the case are, however, far reaching, and would seemingly be applicable to situations where a broker is in receipt of confidential information or a merchant bank or in cases of multiple directorships. Kay and Yates comment that 'a trustee acquiring information pertaining to the trust investments in his capacity as a company director, or a director holding multiple directorships, should surely not be able to remain silent where his second fiduciary position is clearly subordinate to the first.' (386) Thus there would appear to be four possible solutions to the problem.

(a) the so called 'primary rule', that is the first agency agreement predominates in all respects, because the duty owed to the first principal is primary. If this rule is the correct one, it would seem that the second principal might be at his peril, even though he did not know, and should not in the circumstances have known about the prior arrangement. On the other hand it could be that he would have to have either actual or constructive knowledge of the prior fiduciary relationship which accords more with traditional equity principles. If there is no notice, then the position is not certain; presumably the information should not be delivered up although the first principal should have a claim in damages or equitable compensation, as indeed should the second principal if he has suffered damnification.

(b) the agent should be liable to both principals by placing himself in this position, and that although the confidence of the second principal should be preserved, the first one should be able to recover compensation. This would appear unfair where the second principal had notice or the means of notice, and was aware of the unlawful

nature of the situation. If the second agent was not so aware the position would be the same as in (a). Where the second principal was aware of the situation, his conduct would constitute an inducement to breach of contract, and possibly participation in breach of trust.

(c) The American Restatement of the Law of Agency provides that an agent is under a duty to disclose, pprovided that such would not breach a duty owed to a third person.(387) Where this involves a conflict of duties and in spite of this the agent proceeds to act for the second principal, if the second principal has knowledge of the first agency, then the second agreement is illegal and unenforceable.(388) Thus the duty of confidentiality to the second principal is eliminated by the rendering of the second agency unenforceable. In the present case Donaldson J. whilst accepting the second agreement was unlawful, did not hold it to be a nullity however, and thus upheld the duty of confidentiality.

(d) It is possible to argue that the relationship through which the fiduciary came into possession of the information should be the governing factor. Thus information acquired in one fiduciary capacity cannot be used in furtherence of some other relationship, at least not to the detriment of the first. This would eliminate the problem of whether the first relationship in time should predominate or be subservient to another subsequent relationship entered into with or without notice.

Of course, where the information is not protected by confidence then there is no difficulty. Where there is a potential conflict of interest relationship, however, once confidential information goes into the fiduciary the problem crystalises and the difficulty of finding a satisfactory solution arises. It should be noted that in the context of the British Law, it would seem unlikely whether the principle of internal segregation or that of the 'Chinese Wall' would relieve the fiduciary from responsibility.

(D) TIPPING AND TIPPEE TRADING AND THE QUESTION OF CIVIL LIABILITY

Whilst this present study has discussed the question of extended insider status and tippee trading largely, and at length in the context of the securities industry, obviously other sections of the community are no less effected. The Commission recognised this point in its Reply Brief before the Court of Appeals for the Second Circuit in the Texas Gulf Sulphur case. The SEC also pointed out that the danger of tippee trading was that it was not limited to any present category of person, and outside the regulated industries the implications for harm it could cause were astounding.(389) With tippees and the extended category of insiders, in most instances there are no disclosure requirements, and thus detection of communications and transactions, and the identification of participants is well nigh impossible.(390) For instance it is estimated that in the City of London in 1967 over three million telephone calls, excluding internal calls, four and a half million letters, and four hundred and fifty thousand private messages were made and sent on an average business day.(391) The Stock Exchanges publicity film(392) shows a broker telephoning from Geneva and his deal being executed within two minutes, and the Public Relations office makes much of the fact that the Exchange's own automated telephone exchange is larger than that of most towns in the United Kingdom.(393) Thus the problem of identifying a particular communication or leakage of information is truly fantastic. Indeed as Painter states 'if modern electronic devices make the telephone unsafe, the conversation can always be held on a crowded street.', or at a private luncheon or club, or for that matter anywhere else.(394) In the vast majority of cases it will be impossible to establish tippee trading or tipping other then by circumstantial evidence. For example in Texas Gulf Sulphur tipping by Darke was shown inter alia by an examination of the alleged tippee's trading before and after the alleged tipping took place.(395) Detected instances would seem to be the most extreme tip of the iceberg.

Given the profound difficulties of detection it is only those cases where the tippees have some referable and identifiable connection with the source of information that will be caught. Apart from this, the important question arises as to what kind of tippee is to be considered as fairly within the insider obligations. It has to be remembered that the 'abstain or disclose' rule in the present context will invariably only leave the tippee with the choice of abstaining or incurring liability, as he will rarely have either the opportunity or ability to influence disclosure or disclose directly.(396) As Loss has observed 'there is a scale running from the Director of the Corporation X. who gives a tip to his good friend in a similar position with Corporation Y. - perhaps on an express or implied 'I'll scratch your back and you scratch mine' to the director who feels in an expansive mood while having a manicure, there is the studies eavesdropper or the briber, and on the other hand there is the altogether innocent tippee.' (397) In addition there are innumerable permutations of the knowledge that the recipient of the information could have about the nature of the information. Here the range can be from those who have conived with the insider in the breach of his trust, to the innocent recipient who has no reasonable grounds for assuming that there would be any impropriety in using the information. Then there is also the direct tippee, the secondhand tippee and so on. It is debateable where it is appropriate to draw the line of liability. Painter considers that 'it is doubtful whether Rule 10(b)(5) absent a showing of outright fraud or some other unusual circumstances, should be extended beyond the level of the first tippee.' 398) There is also the problem of how specific the information should be and how gossip and rumour can satisfactorily be separated from inside information for the purposes of predicting liability. Whilst there has been a considerable amount of attention afforded to the securities industry and its receipt and utilisation of such information, it is probable that different considerations apply there, given the professional nature of the participants, their public responsibilities

and the degree of regulation. Outside this area there is substantial uncertainty. Although Commissioner Budge has stated that 'the Commission certainly does not contemplate suing every person who may come across inside information ... and that obviously persons such as taxi drivers, the barber, or the caddy, who by chance overhear a bit of corporate news, should not be named defendants in a civil action brought by the Commission', (399) this is hardly satisfactory with regard to suits brought by anyone else.

Certainly it would seem, as has already been pointed out, it is not necessary to discover any formalised relationship between an issuer or insider and the tippee. (400) Although the vast majority of suits in this area of the law have only sought injunctive relief, in recent years there is a trend for a number of class actions to follow closely on the tail of a successful enforcement action. The first square holding outside the Commissions administrative proceedings that tipping of inside information is a violation of Rule 10(b)(5) was in the SEC's enforcement action against Texas Gulf Sulphur Corporation. In this case the Commission only sought relief against the tippers and did not join the tippees. (401) The General Council and staff Attorneys sought to have their arguments on the provisions of Section 20(b) of the 1934 Act that

> 'it shall be unlawful for any person directly or indirectly to do any act or thing which it would be unlawful for such person to do under the provisions of the Act or any rule or regulation thereunder through or by means of any other person.' (402)

With regard to the defendant Drake the Court of Appeals expressed the view that by passing on information he had violated Rule 10(b)(5), and with regard to defendant Coates, the Court considered that ' Coates' violation encompassed not only his own purchases, but also those of his son-in-law, and the customers of his son-in-law to whom the material information was passed.' (403) Bromberg has written that 'given the nature of the financial world, an insider who tips a friend should probably be charged with foreseeing that the friend will tell one or two others, and the

information will continue to spread. Quite conceivably the tipper will be liable for all trades which can be traced to the information eminating from him.'[404]

The information that the two insiders tipped in Texas Gulf Sulphur varied in its specificity. Evidently Darke disclosed that Texas Gulf Sulphur 'was a good buy' and gave some information on the original bore hole, whilst Coates immediately after the first Press release told of the discovery.[405] The Court of Appeals for the Second Circuit gave no rationale for this determination of liability, except the desire for information equality.[406] On referal to the District Court of South New York, Judge Bonsal mentioned that the imposition of liability for the tippees trading on the tipper 'will be a sufficient deterrent.'[407] This was seized upon by the Commission who advanced the deterrent theory in the Court of Appeal in their Reply Brief. The SEC also emphasised that it was preferable from the standpoint of deterrent and enforcement to strike out at the tipper, and thus 'cut the tip at its source.' It is certainly considerably easier from the enforcement point of view to identify and visit liability on the insider-tipper. It has been pointed out by Bromberg that ' as a matter of logic and policy, it should follow that the primary evil is not tipping itself, but trading with inside information. Tipping is a violation because it facilitates such trading by tippees and given the human propensity to communicate, by a long chain for further tippees.'[408] Indeed on this basis Bromberg suggests that it may well be advantageous for the tipper to still be fixed with liability for the trading of distant recipients of information, even though because of the mutilation of the information by communication through a number of persons, they themselves are not in violation of the Rule.[409] It may be a sufficient violation where the insider tipper tips in anticipation, or in circumstances where trading is reasonably to be contemplated, even though the tippee does not infact trade.[410]

Apart from avoiding the complexities of determining tippee liability [411] holding the tipper liable comports with traditional fiduciary notions, in that the tipper who will generally be an insider in the proper meaning of the word will thus be in a fiduciary relationship with the issuer. There would seem to be authority for the proposition that a fiduciary disclosure of information belonging to his principal for the benefit of other than his principal, is a breach of that relationship. [412] Tippees themselves will also be liable for tipping. This was established in the Merrill Lynch proceedings where it was laid down that 'one who may not himself trade in securities without disclosing information known to him may not pass that information to others for their use in securities transactions.' [413] Whilst it was quite early on, as has been seen, established that tippees will be liable for trading on inside information in administrative proceedings, the position of such in civil cases has remained until recently in some doubt. The Court of Appeals in Texas Gulf Sulphur considered that trading by tippees 'with actual or constructive knowledge that the material information was disclosed ... certainly would be equally reprehensible' as that by tippers and access insiders. [414] Thus the Court of Appeals for the Second Circuit considered that at least morally tippees were in the same position as insiders and, of course, in Ross v. Licht, the District Court of South New York regarded tippees as insiders. Whilst the idea of imposingcivil liability on tippees has been criticised, [415] the question was placed beyond dispute, as has already been mentioned by the <u>Shapiro v. Merrill Lynch</u> litigation. However, whilst the possibility of tippee liability is resolved, the constituents of that liability remain largely uncertain and unresolved. District Judge Tenney considered that 'the selling defendants or tippees who, the complaint alleges, knew or should have known of the confidential nature of the information, are liable to the same extent as the insiders.' [416] In the Court of Appeals Circuit Judge Timbers found liability on exactly the same basis, except with the addition of the phrase that 'they knew of its non-public nature.' [417]

Thus these statements would seem to suggest that all that is required is that the tippee should objectively have known of the 'confidential nature of the information' and its non-public quality, and that his liability is the same as that of an insider.[(418)] Of course with regard to those tippees not in a direct relationship with the issuer, important considerations of specificity and reliability will feature in the determination of materiality to a much greater extent than in the case of access insiders.

It has been argued that where there isa chain of communication through a number of tippees, there is in effect a sufficient public disclosure, so as to render the information no longer of a non-public nature. In the matter of Faberge, the Commission categorically rejected this, and emphasised that 'the information was not disseminated in a manner making it generally available to the investing public until the issuers press release appeared on the broad tape.' This is significant as there had already been an announcement in that case on the AUTEX Tape, which the Commission discounted in view of the fact 'that it had been transmitted only to a limited number of institutional investors.' In the case of tippee trading information, 'in order to effect a meaningful public disclosure of corporate information ... must be disseminated in a manner calculated to reach the securities marketplace in general through recognised channels of distribution, and public investors must be afforded a reasonable waiting period to react to the information.' Thus the SEC seemed to reject the notion that effective disclosure could be made through selective communications. The Commission considered that any other possibility 'would be to sanction competition for tips in which ordinary individual investors would inevitably be at a serious disadvantage.'

Another problem that is ignored by the treating of the tippees position as the same as that of the insiders, is that the insider will be in a much better position to evaluate the information and determine its reliability. In the Texas Gulf Sulphur case, the Courts introduced a probability factor into the definition of material information. This is important in the case of tippees, as they will generally

have very little opportunity for testing the reliability of the information, and will not have the background knowledge that insiders have. Thus Bromberg considers that in the case of remoter tippees 'a higher probability of accuracy ought to be necessary as an element of the violation.' (419) Obviously the lower degree of probability that the information is correct and accurate, the less harm the use of that information does to the concept of equality of information. Thus to a certain extent differing standards of materiality are applicable to access insiders and mere tippees.

(E) THE DEFENCE OF IN PARI DELICTO

An interesting problem arises where the information given to the tippee, which he utilises for trading, turns out to be erronious, In such a case the question arises as to whether the tippee can sue the informant. The problem resolves itself into a conflict between the public policy consideration that the tipper should in all events be discouraged from misleading another investor, and the equally important public policy principle of 'inclean hands'. There have been a number of cases in the context of Rule 10(b)(5) where 'in pari delicto' has been raised as a defence, but here attention will only be given to the most recent.(420) The leading case here is that of Kuehnert v. Texstar Corporation,(421) The Texstar Corporation was negotiating a merger with another corporation. The defendant President of Texstar told his friend Kuehnert of the merger plans and of secret oil discoveries which would have, when announced,greatly increased the value of Texstar securities. The President, because he was having difficulty with his colleagues suggested that both he and Kuehnert purchase considerable Texstar securities so as to strengthen his position, and also to net a profit, before the developments were announced. The President emphasised that it was crucial to the success of the scheme that Kuehnert keep the information confidential. Without disclosing the information Kuehnert made substantial margin purchases of Texstar common stock. It turned out that most of the assertions and information that Kuehnert had been given were false. Kuehnert, having suffered a considerable loss, brought suit against the President under Rule 10(b)(5). The District Court for South Texas granted the defendant's motion for summary judgement on the grounds that Kuehnert had himself violated the rule and was defeated by the 'unclean hands' maxim.(422) The Court of Appeals for the Fifth Circuit affirmed this.(423) The ratio of the decision was 'we think it important that tippees, who present the same threat to the investing public as do insiders themselves, should be offered appropriate

discouragement, we conclude that the better choice is to leave upon persons believing themselves tippees the restraint arising from the fear of irretrievable loss, should they act upon a tip which proves to have been untrue. Hence the loss must lie where it falls.' [424]

The same problem arose the following year in Wohl v. Blair & Company.[425] In this case a registered broker told the plaintiff that he had inside information relating to a certain issuer, which made purchase of the securities of that company very desirable. The plaintiff agreed and the broker executed the transaction. The shares actually fell in price and it was obvious that the assertions of the broker were false. The plaintiff proceeded to suit under Rule 10(b)(5). The defendant sought to reply upon the principles of 'unclean hands', whilst the plaintiff contended that these principles were not applicable in the present case. He sought to distinguish the Kuehnert decision on the grounds that in the present case the defendant was not an insider of the issuer and was a broker, owing him a fiduciary duty of disclosure. The Court refused to accept these technical distinctions between one who is in fact a corporate insider, and one who merely claims to have possession of inside information. The Court espoused a 'caveat tippee' policy that a tippee taking and using inside information did so entirely at his own risk.[426] Where a person who is a tippee claims that he is fraudently induced to purchase securities on the basis of what he mistakenly believes to be inside information, he will be barred by the defence regardless of where the information comes from. The difficulty with this case is, whilst fully accepting the reasoning and approach of the Fifth Circuit, the position was not analagous to that of kuehnert, as a broker, even if not in a special position, has a direct pecuniary interest in his clients transactions by virtue of commissions. Thus in the present case the broker is allowed to neglect his fiduciary duties to his client because of the public interest in preventing the use of inside information, even where there is none.[427]

The aim of these decisions however, in every case of of such actions and not only where a broker is involved, is to effectively isolate the fraudulent 'tipster' from liability at the suit of his tippee. This would apply whether the information imparted be true or false.[428] Of course, where a tippee traded to his advantage on true information, he would be unlikely to draw attention to his own wrong, by suit, even if there was a detriment. The same reasoning as that adopted in these decisions would presumably apply so as to remove the tipper from liability to those to whom the tippee passed on the false information. Thus as Gene G. Harter and Lawrence B. Ordower point out in the California Law Review,[429] 'the net effect is to remove the sanction of civil liability almost completely from this type of securities fraud.'. Of course, this has been criticised as it removes all protection from the greedy and gullible investor, of whom there must be many. Whilst perhaps not practically objectionable, this is a new departure, and absent the question of insider trading the law does not usually condone deceit and misrepresentation of this ilk.[430] Furthermore, the original tippee will only make the statement in the expectation either directly or indirectly of some reward, whether it be esteem, commissions, retention of control or manipulative design. Indeed Circuit Judge Godbold who dissented in the Kuehnert case, and the District Court in a subsequent, expressly rejected the application of the defence of in pari delicto.

The District Court of South New York in Nathanson v. Weis, Voisin, Cannon Inc.[431] the plaintiff contended that he had received inside information from Weis, Voisin, Cannon Inc. thattwo corporations, of which the brokers were in a variety of insider relationships with, were about to merge on very favourable terms. In fact this never materialised. In this case the Court considered that if the prophylactic purpose of the anti-insider trading provisions is to restrict the use of all material inside information until it is generally available to the

investing public, 'then the most effective means of carrying out this policy is to nip in the bud the source of the information, the tipper, by discouraging him from making the initial disclosure which is the first step in the chain of dissemination.' The Court thought that the central question was one of policy and which approach would best serve the interests of the investing public. Of course, the Court in Kuehnert had said the same thing and come to the converse result.[432] The Court was not persuaded by the plaintiff's argument that the information received by him could not have constituted a fraud upon the public as there was no inside information, on the grounds that such had not been disclosed to the persons with whom the plaintiff had dealt, and that his conduct with regard to the investing public 'was similar to that attributed to the defendants own recreant conduct, and that whilst such was a factor to be considered it was not disposive of the case.[433] On the other hand the Court did not consider that the conduct of the tippee was not dispositive of the application of defense of 'unclean hands'. The Court adopting much of the reasoning of the dissenting Judge in the Kuehnert decision, emphasised that the tipper presents a greater threat to the investing public than the tippee and thus the liability should properly be fixed upon him, and to this extent a denial of the application of the principle of in pari delicto better effectuated the public benefit.[434]

The position has become considerably confused however, with the subsequent decision of the Court of Appeals for the Fifth Circuit in James v. Du Breuil.[435] The facts of this case are complex and it is sufficient here to point out that the plaintiff alleged that he had been fraudulently induced by the defendant to sell his securities to him, the defendant being a director in the issuer, for placement in a trust, believing that his shares would have greater value after an announced merger was affected. The District Court of South Florida dismissed his claim on the grounds that 'the plaintiff was a co-conspirator

with the defendant in an intended act of fraud and deceit' and 'that he was just as involved in the fraud as the defendant was.' Thus the District Court followed the Kuehnert decision. On appeal to the Court of Appeals for the Fifth Circuit, in which Circuit Judge Moore of the Second Circuit was sitting by designation, the lower decision was affirmed and the Kuehnert decision approved. As a matter of policy the Fifth Circuit considered that 'it is better to leave upon the persons believing themselves tippees the restraints arising from the fear of irretrievable loss should they act upon a tip which proves to have been untrue.'

Thus it would seem that the weight of authority is behind the availability of the defence of in pari delicto in actions under Rule 10(b)(5), in the context of insider trading. At least some of the controversy has resulted because Rule 10(b)(5) effects considerably more than just insider trading. To deny the defence furthers the rule as a remedy for deceit and misstatement, to apply it arguably discourages tippee trading. It is noticeable that other Courts, and indeed the Supreme Court, have disapproved of the application of the in pari delicto principle where the suit serves a significant public interest.(436)

The acceptance of the principle as a defence or bar to suit, does neglect the vital importance of effective civil enforcement to anti-insider trading provisions. Indeed the insider who disclosed the information will go unnoticed and unpunished, even though he has abused his corporate trust, wither by passing on inside information, or by using his insider status as a means of imbuing his false information with credulance. Indeed in every case the plaintiff relied on the false information because he was impressed with the status of his insider informant. Furthermore, it is to be doubted whether the desired discouragement of tippees using their privileged information because of the knowledge that they act at their own risk, will rarely be more than a theoretical proposition.

As we have already seen the securities industry, and indeed many investors, are sceptical of mere tips, unless from a trusted friend or in confirmation of an existing suspicion. Indeed the record in Kuehnert v. Texstar Corporation shows Kuehnert stating, with regard to his informant, 'I had great faith in him, he was a good friend of mine, and I had no reason to doubt the man. I had no reason at all to doubt him. He was a very, very very close friend.' (437) Similarly in the Texas Gulf Sulphur case, the tippees who traded were relatives and close friends of Darke and Coates. Thus it is hardly likely that on receiving a 'tip' from such intimates, the possibility that they might be giving false or mistaken information, with knowledge and indeed the intention that it will be utilised, would rarely weigh much in the recipients mind. Of course there will be cases where the tip was innocently mistaken or purely negligent, but in such cases it is harly likely that the recipient is going to sue, probably in deceit, his informant. At most it might make him more prudent in the future. In the case of professional advisers and brokers, slightly different considerations pertain, but even here it is most unlikely that a professional would be disposed to risk the loss of custom by feeding investors with deliberately false information. Indeed under the defence of in pari delicto professionals are encouraged to perhaps take less care in their recommendations, if couched in the form of a tip. Given the desire for brokers and advisers to please their clients, and the ever present threat of disciplinary action, and bad publicity, it is open to question how many brokers clients would, on receipt of a tip, be persuaded not to use it because of the fear that if it is wrong and even fraudulent they will not obtain redress. There are a number of yet unresolved difficulties about the application of the defence of in pari delicto and doctrine of 'unclean hands', which are of course not necessarily the same thing. For example the position of a tippee where there is no consensual relationship between such and the insider, is yet undecided. It is certainly difficult to speak of an eavesdropper or a secondhand

tippee as a co-conspirator of the insider. There is an obvious need here for a through rationalisation of the law and policy considerations.

It should be pointed out in passing, that a stockholder cannot recover on the grounds that other persons were tipped, but he was not.[438] Of course a contrary result could mean that where the information was bullish, an insider could be liable to virtually anyone.

Vitally connected to the determination of insider and tippee liability is the question of what type of information will create a sufficient trading privilege to warrant liability. In this respect the most controversial consideration is whether outside or market information is sufficient. This is a matter of tremendous importance to the regulation of tippee trading and the possibility of an extended definition of insider.

(F) MARKET INFORMATION OR OUTSIDE INFORMATION

The SEC in its Securities Exchange Act Release asking for comments on the drawing up of guidelines on the use of non-public information, specifically asked for comments on 'the appropriateness of utilising non-public material information directly related to the future market for a given security which does not emanate from or concern the issuer of those securities.' (439) In other words this relates to information which, although not effecting the intrinsic worth of the corporation, does nonetheless bear upon the market price of that company's securities. Thus this type of information effects the demand and manner of trading in the corporations securities rather than its earnings or assets. (440) Classical illustrations of market information would be advance knowledge that a large institutional investor intends to sell out its present holding of a particular security, or indeed acquire more of such securities, or advance knowledge that a particular security is going to be 'wrote up' in a pending publication. (441) This type of information can of course, be just as price sensative, if not generally more so, than the traditional types of inside information. Indeed the practice of scalping and trading on the impact of investment recommendations particularly in the press, has already been mentioned, (442) as has the advantages enjoyed by floor traders and specialists. (443)

One eminent American securities lawyer, Martin Lipton has written that 'a President of a corporation who learns in an interview with an analyst that the brokerage firm is going to make a favourable recommendation of the corporations stock, is in the same position with respect to trading without disclosure, as when he learns that the corporation has made a major mineral discovery.' (444) The American Law Institute take a similar view and so provide in Section 1303 of their Draft Federal Securities Code. (445) Indeed it would appear that it is the better view that 'outside facts do not have any pervading immunity from the prescriptions of the anti-fraud rules.' (446)

On the otherhand the Chairman of the SEC, Ray Garrett, at the London Conference on Insider Trading in the Spring of 1975, doubted whether this proposition was correct, and thought that the matter was still open to question. Although no case has discussed the standing of market information, there are numerous decisions where categories of market information have been treated as inside information, subject only to the criteria of materiality, without discussion. This is hardly satisfactory however, as there are a number of points that still require clarification and deliberation.

There is a difference in nature between inside information eminating from the issuer, which it possesses, controls, and in most instances manufactures, and the kind of information that is here being considered. The receipt of outside information by a corporation places it in something of a tippee position with the attendant difficulties of that status. The problem that tippees have in determining reliability, evaluation and in controlling the information, apply in such a situation. In most cases the recipient of market information will have scant opportunity to disclose such, and where recommendations are involved disclosure could be construed as manipulation, particularly if the effect of the disclosure was to result in the withdrawalof the recommendation.(447) Another problem is that market information generally always relates to future market activity and thus the disclosure of such will inevitably prejudice the impact of that contemplated activity. For example if a large institutional investor was obligated to announce in advance its intention to make large scale purchases, or a potential tender offeror was obligated to disclose in advance its intentions, the market would turn against the institutional investor or offeror and possibly even frustrate the acquisition. These problems have already been alluded to in the context of takeover regulations, but it is important to realise here, that the difficulties of market information disclosure are very much wider. In <u>Hafner v. Forest Laboratories</u>(448)

an action was brought against the issuer alleging a violation of Rule 10(b)(5) in its failure to disclose an impending 4% stock dividend to the plaintiff before it purchased his securities. The Court of Appeals for the Second Circuit stated there was no such violation, but indicated that in certain circumstances such conduct might be violative.

Certainly the SEC has become conscious to the dangers of abuse in this area in recent years. Although Commissioner Loomis stated in a Panel discussion with the Financial Analysts Federation in 1972, (449) that information obtained by brokers and dealers on their clients investment intentions and positions was 'not inside information,' it is open to question whether a similar view would be taken to-day, at least with such assurance.(450) Under Rule 144(h) the SEC requires contemporaneous filing of notices of intention to sell under Rule 144, and under this, the sellers intention to sell, the amount of securities to be sold, the market place at which the securities are to be sold, and the name of the selling broker must be disclosed. Thus as this is a public document 'market makers and others are provided with an access to information about the availability of supply and the potential selling pressure on the particular security.' (451) The Commission and also the self-regulatory agencies have also been alert to the danger of persons engaged in the securities industry generating their own market information and utilising it to their own benefit. Reference has already been made to the proceedings brought against certain financial analysts allegedly guilty of such conduct. (452) The New York Stock Exchange has also disciplined analysts who have disclosed to others the fact that they or their associates are about to publish a negative or favourable report on a particular security. (453) Advance knowledge of impending legislation or administrative decisions, and also probably for that matter judicial decisions, has also been considered inside information. (454)

One of the most difficult problems with predicting liability in this type of case is where the material outside information is used by a non-insider. Whilst the SEC has been

particularly concerned about professionals utilising such information 'to gain trading advantages over public investors,' (455) it has also been concerned about the advantages that can be obtained by misuse by anyone. (456) The Courst have been more ready to find liability where professionals are involved however, given the nature of their relationship with the issuer and public investor. Where non-professionals and insiders are involved, it has generally been thought that a Court would reject an action on the grounds of materiality. Materiality in the present context has generally been associated with 'undisclosed events which have a significant long term impact on the company,' (457) and of course outside information not related to the intrinsic value of the issuer would not normally have this long-term effect. With the adoption of the reasonable investor test, and the extension of such to speculative investors, this problem would seem to have ceased. Furthermore, in certain instances market information can, of course, have longterm repercussions, such as in the case of take-overs and public issues.

Apart from the materiality problem the Courts have normally only imposed an affirmative duty to disclose material information, or to abstain from trading where there is 'a relationship giving access directly or indirectly to information intended to be available for only a corporate purpose, and not for the personal benefit of anyone.' Generally in the case of outside information, there will not be this relationship with the person utilising the information and the issuer of the relevant securities. Given the vastly extended notion of insider trading, in this situation it has been argued that this is not determinative, and attention should be given to the other constitutent of liability, namely, 'the inherent unfairness' of the personal exploitation of such information. Where a corporate insider learns of outside information about his corporation's securities, it is probable that his relationship with the issuer will be sufficient to ground liability upon. The difficulty lays in those cases where, for instance, an investment house of

of some influence informs a large mutual fund that it is going to recommend and push the securities of a particular company with which the mutual fund has no insider relationship. Here the law and academic comment is most uncertain. In SEC v. Great American Industries Inc,(458) the Commission contended that 'Rule 10(b)(5) placed an affirmative duty of disclosure on persons who in contrast to insiders and brokers and dealers, did not occupy a special relationship to the seller or buyer of securities. The Court thought this 'would be occupying new ground and would require most careful consideration', and the Court was not prepared to accept the contention on the facts of the case. Circuit Judge Kaufman, whilst concurring, considered that it would be wrong to think that Rule 10(b)(5) could not be extended to such instances, and at least in injunctive suits 'any claim that material facts were withheld in a transaction in connection with the sale or purchase of securities, must be scrutinised with care, whether or not there would have been liability at common law for such a deed.' (459) The trend for parity of information in both judicial and administrative actions has continued. In the Investors Management case the Commission stated that the 'tippees' were liable if they knew or had reasonable grounds to believe that the information was non-public and had been communicated to a privileged group regardless of the actual source.(460) Indeed Commissioner Smith, whilst concurring in the result, thought that liability should continue to be predicted upon,

> 'the respondants knowing or having reason to know that the material information became available to them in breach of a duty owed to the corporation not to disclose or use the information for non-corporate purposes ....and not merely on the notion of relative informational advantages in the market place.'(461)

Nonetheless, the Commission has continued to eliminate 'informational disparaties', particularly market information relying upon the traditional unfairness factor.(462)

Certainly Fleischer, Mundheim and Murphy in their leading article on market information consider that the parity of information approach in cases where there is no insider relationship is too restrictive, and would depart significantly from any underlying assumption of competitive economy, that it is desirable ... to reward the diligent who have acquired a superior market position.' (463) Furthermore, it is argued that the parity approach ignores the distinction between the voluntary acceptance of fiduciary responsibilities and their infliction by the law. Instead of the notion of parity, the learned authors consider that the so-called 'fairness principle' could be utilised as a basis for 'permitting the user of material non-public information to show that his exploitation of that information represented a legitimate reward for the economic effort by him or the person who provided him with the information.' This would in their view strike a balance between the need to provide public confidence in the integrity of the market, whilst promoting efficiency of capital allocation. On the other hand Martin Lipton writing in Practical Guidelines for Inside Information, considers that the Courts, as well as the Commission, have supported the parity approach and this is the correct rationale.[464] Whilst it is probably correct that the congress did not originally intend to lay down a rule of parity of information, with cases such as the <u>State of New York v. Bankers Life and Casualty Company,</u>[465] and in particular <u>SEC v. Texas Gulf Sulphur</u>[466] this would now seem to be a legitimate expectation of the market. Nonetheless, it is true that many Courts, whilst actually dealing with outside information, still feel constrained to discover some notion of insider relationship, no matter how artificial...[467]

Given the above discussion, it must be emphasised that the exact boundaries of the duty to disclose material 'outside information' accepting that such a duty exists, are uncertain. Of very great importance is the question

whether there is a duty upon corporations which fully intend to make a public offer for the securities of another, to disclose this intention when making pre-announcement acquisitions, or when allowing others in association with that corporation, to make pre-announcement acquisitions. Fleischer, Mundheim and Murphy, writing in the University of Pennsylvania Law Review, consider that 'it seems clear that under these circumstances the corporation has no obligation under Rule 10(b)(5), or its Williams Act analogue, Section 14(a) to disclose its plans before making market purchases'.(468) It is interesting however, that although Rule 10b-13 only prohibits transactions outside the terms of a tender offer during the currency of such, the SEC has indicated that the same principle should be applicable to transactions immediately before such, and that in any case such have to be disclosed under sections 13d and 14d. (469)

The SEC in its Institutional Investors Study considered that the privileged communication of information to institutional investors concerning impending tender offers and the like, violated rule 10(b)(5).(470) It is uncertain however, whether warehousing by the potential offerer with others could be considered a violation of the Federal rule. The SEC's Institutional Investor Study thought that warehousing should be regulated under a new provision rather than under Rule 10(b)(5). It has been argued that the plans of the acquiring corporation are valuable items of corporate property and should thus only be used for the benefit of the corporation, and not by tippees. It would follow that the corporation would have an action against both the warehousers and also the insiders who disclosed the intention to make an offer. The Court rejected such a contention however, in Penn Mart Reality Company v Becker,(471) on the grounds that there had been no deception and that the company's insiders were entitled to negotiate support for the offer.(472) Of course, in acquiring the support of institutional investors both in terms of financial and voting support, the management might be performing a most necessary and beneficial role from the standpoint of the corporation,

which would not without such assistance be able to exploit its superior market analysis or position. Indeed in such situations corporations have relied upon directors to acquire securities in the target in support of its offer and objective. (473) Without the realisation of the corporate acquisition the superior analysis of the offerer is wasted, and will only benefit others by drawing attention to the undervalued securities of the target corporation. Thus in some instances 'warehousing permits potential acquiring companies who cannot secure financing by conventional means to take advantage of their self generated analysis that the target's stocks may be undervalued'.(474)

Another dimension to this problem is where an insider of the corporation which is about to make the offer acquires securities in the potential target corporation in contemplation of this event, and not for or in agreement with his corporation. It would seem that the insider might be liable under state fiduciary law to his corporation on the principles laid down in Brophy v Cities Service Company (475) it is also possible that he might be held liable under Rule 10(b)(5) to his company on the principles that have already been discussed. His liability to anyone else other than his corporation, particularly to the shareholders of the target company who have sold their securities prior to the public announcement of the tender offer, is far more dubious however. There would be no claim under state law as there has been no misrepresentation, and there is no fiduciary nexus so as to base an affirmative duty of disclosure upon. It would seem difficult to find any duty to disclose the contemplated transactions by his corporation even under Rule 10(b)(5), notwithstanding the dicta in SEC v. Great American Industries, which has already been alluded to. The application of the fairness principle would seem to allow the offerer to take advantage of its superior analysis, and likewise presumably anyone else which it considers should be allowd to profit

There was no allegation that the manager disposed of his securities to such, as in the case of scalping.
The SEC contended that there should have been disclosure of this earlier transaction to the clients. [476]
On the other hand the SEC's Special Study of the Securities Markets [477] pointed out that the investment by the adviser of his own funds in the recommended security did testify to his bonafidies. The complaint is in the prior nature of these investments, and thus the enhanced price that they are acquired at. [478] The Sec has stated that it will extend this basis of liability to bar pre-recommendation purchases by both investment companies and other affiliated with such, or advisers. [479]
The SEC has expressed concern that persons associated with an investment company can make purchases or sales on the basis of contemplated transactions to be made by the investment company, and the disagreement in the industry about the ethics of such conduct. [480]
The Congress accepted the SEC's recommendations and increased the SEC's rule-making power in this field. It is now provided in Section 17(j) of the Investment Companies Act that 'it shall be unlawful' for any person affiliated to an investment company, its advisers or principle underwriters 'to engage in any act, practice or course of business in connection with the purchase and sale directly or indirectly by such person of any security held or to be acquired by the investment company, in contravention of such rules that the SEC may promulgate' to prevent such acts, practices or courses of business as are fraudulent, deceptive or manipulative.' [481]

The Commission has proposed an extensive regulatory code for this area in the form of Rule 17(j)-1. [482] This Rule largely conforms to the Proposed Code of Ethics drawn up by the Investment Company Institute although there are some significant differences. Given the critical importance of this regulation it is worth describing Rule 17(j)-1 in some detail.

personally, provided of course this comports with a corporate interest or purpose. This would not of course exonerate the conduct of the insider who took advantage of his position to acquire an unauthorised personal advantage. The difficulty with the fairness principle is that apart from being vague, it can easily blur into the so-called parity principle.

As has already been pointed out the Congress did not conceive of parity of information or probably even fairness as the guiding light to Section 10b, and until the last few years liability has not ventured outside a finding of some kind of insider relationship, invariably of a fiduciary or public nature. Although recent cases have advocated parity, like equality, this must be seen only as a goal and not necessarily as a matter of substance. Informational inequalities will always exist; they are creatures of time, distance and inequalities of wealth. Informational parity would be largely meaningless without equality in other areas, such as in comprehension, evaluation, and ability to execute. To espouse the equality norm in the present context of securities regulation can at best provide an ultimate unrealiseable goal, meaningful attainment of which would destroy the very structure that the principle has been called into existence to strengthen. This is not to say that as a concept it cannot be a meaningful criteria and operative guide.

Reference has been made above, and also in the previous discussion of tippee liability, to the profound advantages open to the professionals engaged in the securities industry to both generate and capitalise upon market information. Apart from scalping, it has been held that the mere purchase of a security before recommendation may amount to fraud under Rule 10(b)(5). The SEC has proceeded against a registered investment adviser and its manager, when it appeared that the manager transacted business for his own account and that of his family's, before recommending the security to the firms clients.

The Commission have defined the term 'securities' extremely widely so as to comprehend all securities being considered for recommendation or for purchase or sale by the registered investment corporation. This would also include securities convertible into that class. The SEC have also sought to specifically define the insiders comprehended by the new regulation. The SEC defines 'access persons' to include any director, officer or advisory employee of a registered investment company, any partner, director, officer or advisory employee of the investment adviser or underwriter. An advisory employee would include any employee of the investment company or adviser who is involved in recommending transactions by the investment company, or who obtains information concerning such recommendations other than as a regular client of the adviser. Thus this definition would include those persons not immediately connected to the formulation of recommendations 'as for example secretaries who might become aware of recommendations through their normal work.' (483)

Subsection (b) of the new rule deals with the Commissions definition of 'fraudulent, deceptive and manipulative devices.' The acts and devices comprehended are similar to those outlawed by Rules 10(b)(5) and 15c-2 of the 1934 Act and Section 206 of the Investment Advisers Act of 1940, although under the proposed rule the Acts and Commissions so described will only be unlawful if they are perpetrated by an affiliated person of the registered investment company, its advisers or principal underwriters. It is expressly provided in Rule 17j-1(b)3 that the terms deceptive, fraudulent and manipulative, are not to be regarded as limited or circumscribed by any specific definitions contained in the rule. This refers to sub-section (c) which specifically defines certain fraudulent deceptive and manipulative practices or courses of business in relation to Section 17j. It is there provided that it shall be fraudulent, deceptive and manipulative within the meaning of that section for any access person to

purchase or sell securities directly or indirectly, in which that person has, or by reason of that transaction acquires any direct or indirect beneficial interest or ownership, and which such person knows is currently being purchased or sold by the registered investment company, or is being considered by such, or is being recommended, or is about to be recommended by an advisory employee of such investment company or investment adviser. The SEC in its accompanying release made it clear that the last situation is only intended to include those situations where the advisory employee's consideration ofa security has reached an 'advanced stage' and 'it would not cover for example, securities reviewed as part of a general industry survey or a general monitoring of the securities market.' (484) Market information is clearly within the scope of this anti-insider trading device, this is made absolutely clear by the Commission,(485)

> ' Thus there is no question that the rules under Section 17j. may cover transactions based on extrinsic information about the portfolio company rather than intrinsic information about the company earnings and prospects.'

Another provision aimed at discouraging insider abuse of market information in the present context is Rule 17(j)-1(d). This provides that every access person other than a partner, director or officer of a principal underwriter which is not an affiliated person of the investment company or its investment adviser, and who does not serve as a director or officer of the investment company or its adviser, must file with the investment company, investment adviser or principal underwriter, of which he is an affiliated person, a report of every transaction in which he has, or by reason of such transaction acquires any direct or indirect beneficial interest or ownership in a security, except transactions exempted from this provision, not later than ten days after the end of each quarter in which the transaction was effected.

This report must state the title and amount of securities involved, the date and the nature of the transactions, the price and the name of the broker or dealer through which the transaction was executed. Even if no such transactions have been executed, a statement to this effect must be made each quarter. Although these reports are not available to the public, they can be inspected by the SEC. It is further provided that each registered investment company, and each investment adviser, must designate by name, those persons who come within the class of 'advisory employee', and are to inform those persons of their duties to file reports and observe the provisions in the Rule.(486)

In addition to these substantive requirements, the self regulatory approach indicated in the reporting requirements is given additional impact by Rule 17(j)-1(e). This provides that registered investment companies, their investment advisers and principal underwriters, must adopt a written code of ethics, establishing as a minimum such standards as are reasonably necessary to prohibit affiliated persons from engaging in any acts, practices or courses of business which have been declared to be fraudulent, deceptive and manipulative. It is provided that such codes may prohibit access persons from dealing in securities 'without obtaining prior written clearance from persons designated by the board of directors of the registered investment company, adviser or underwriter. If such a provision is included in the written code 'any person who effects a purchase or sale after obtaining such prior written clearance shall be deemed not to be in violation of paragraph (c) of the Rule. No such written clearance would be granted if the security in question is being purchased or sold by the investment company or being considered for such by the investment company or adviser. Where clearance is refused it is provided in Rule 17j-1(e)2(i) that the person concerned should be able to appeal to a designated body of the investment company, investment adviser or principal underwriter. Permission can then only be given if the transaction 'would not result in any advantage to such investment company and that the prohibitions of paragraph (c) should not be applied to such circumstances

giving due consideration to the policies and purposes of the Act and Rule'. Written record including reasons for refusal of permission must be kept. To reinforce this provision Rule 17j-1(e)3 provides that all reports filed must be recorded and such are to be reviewed by the investment company, adviser or principal underwriter for the purposes of determining whether there has been compliance with the code of ethics. Where a violation is discovered a report must be immediately made to the board of directors of the registered investment company, and within ten days of this, the board must inform the SEC both of the violation and what action they have taken. Finally, it is provided that the investment company, adviser and principal underwriter will not be considered to have violated the rule by reason of the actions of any other person if it is established that it instituted adequate procedures and used reasonable diligence in carrying out the provisions of the code.

Pre-recommendation transactions are also forbidden under the rules of the major North American Stock Exchanges. For example, the New York Stock Exchange and American Stock Exchange prohibit their members from maming transactions on their own accounts, or passing the information to outsiders prior to the making of the recommendation, and even after the recommendation has been released to clients, Member Firm's personnel may not act 'for accounts in which they have an interest either in accordance with or contrary to the recommendations until the market impact of the recommendations is spent'.(487)

In the Commissions proceedings against the father and son financial journalists in the Campbell case, to which mention has already been made, it was alleged inter alia that there had been a violation of Rule 10(b)(5), in that there had been no disclosure to the persons from whom securities were acquired in advance of the publication of the favourable article, of this fact.(488)
The implications of this complaint are highly significant. Suppose that an over-the-counter retail dealer, as a result

of superior analysis of publicly available information concludes that a particular security is a good buy, it is open to question whether he can amass a position for himself before he recommends a purchase of that security by his customers, and if indeed he does, whether he must disclose his forthcoming recommendation to the sellers from whom he acquires these undervalued securities. It would appear that he must make full disclosure to the persons to whom he makes the recommendation. To require disclosure of the impending recommendation would certainly mean progressing beyond the so-called fairness approach and into the realm of parity of information. Of course where certain priority customers are informed in advance of the recommendation and thus allowed to capitalise upon the market impact of such liability might well be predicted,(489) to the sellers and also the purchasers when they sell. There can be no analogy here to the potential offeror which is desirous of obtaining the assistance of investors because of the need to harness additional capital. On the other hand it would seem that liability is not necessarily to be predicted because a particular broker does not make the results of its research available to all investment clients similtaneously.(490) Generally communication will be upon the basis of economic importance and this would seem to comport with the expectations of most clients, and provided the basis of priority communication is known, there would appear to be no real objection.(491)

Thus in conclusion it must be emphasised that the American law on liability for failure to disclose or misuse 'outside' information is uncertain, and in places dangerously vague. There are areas, in particular those covered by the proposed Rule 17j which are more or less clear, but the vast remainder of the topic remains obscure. The traditional relationship test for predicting liability is nebulous and artificial in the present context, and although cases have indicated an extended tupe of relationship, with the securities market as a basis for liability, this would seem little more than a statement

of the fairness or even parity of information approach. The American Bar Association in their letter of Comment to the SEC. thought that 'it would be appropriate for the Commission to establish guidelines as to the disclosure requirements for outside facts.' But the Bar added that 'not every failure to disclose material information constitutes a violation of the anti-fraud rules. There remains the requirement that the non-disclosure either renders some other statement misleading or itself comprises part of an artifice or course of business operating as a fraud upon the other party to the transaction.' (492) Furthermore, it was pointed out that it may be preferable to deal with the question of outside information in the context of certain securities professionals by special devised rules.

(3) SECURITIES MARKETS SURVEILLANCE AND TIMELY DISCLOSURE IN THE UNITED STATES OF AMERICA

(A) SURVEILLANCE OF SECURITIES MARKETS

In the present author's mind critical to the enforcement of anti-insider trading rules is the question of market surveillance. This is a vital facit to the detection of the abuse and without it, detection and thus enforcement in sophisticated securities markets can only achieve minimal effectiveness. In discussing this topic it is again to North America that we must turn.

(a) THE NEW YORK STOCK EXCHANGE (N.Y.S.E.)

The North American Stock Exchanges consider that the maintenance of market surveillance is nothing more or less than is required by their duty to ensure the existence of a fair and orderly market.(493) It is not an extra luxury but something integral to the market.

The Stock Watch programme on the N.Y.S.E., and for that matter on the other national securities exchanges, 'is tied closely into the policy of timely disclosure' and viable surveillance can only exist if there is a high degree of liaison between the two.(494) The Stock List Division is under the control of a Vice President of the Exchange, and the Division is divided into several Departments. The most important from the point of view of the present discussion is that of Corporation Liaison. Each listed company is assigned to a Listing Representative who is a member of the staff of the Department of Corporate Liaison. The allotment of corporations to these representatives is upon a geographical basis.(495)

The normal method of publication of important developments by a company is by a press release, communicated to the press or a wire service in written or verbal form. But where this is done it must be for immediate release. The Stock Exchange realises that companies can hardly be made responsible for information once it has gone out of its direct control.(496) Where such a release is made shortly before the commencement of trading or during such,

the N.Y.S.E.'s Timely Disclosure Policy 'recomends' that the company contact its relevent Listing Representative,' no later than simultaneously with the release or the announcement of the news to the media.[497] The Senior Staff Attorney of the Division of Market Surveillance informs the present author that this is interpreted as being mandatory and not merely permissive.[498]
The Listing Representative of the North-east Region informed the author that as a matter of courtesy most companies would inform their Listing Representative at least fifteen minutes before the release.[499] As soon as the Representative receives this advance information he will pass it to the Corporate Liaison and Surveillance Coordinator. The Director of the Corporate Liaison Department, Mr. Dick Grasse, considers however, that 'if the representative has been doing his job properly, he will be able to guess that a release is coming through or more to the point, should be coming through.[500] The Department keeps copious files on each issuer, and the Coordinator apart from constantly checking with the Listing Representatives continually scans the news media for indications that a release is pending or should have been made.[501]
The Expanded Disclosure Policy of the N.Y.S.E. makes it clear that one of the main reasons why it requires prior notification is so that it can decide whether the market needs a temporary 'hold' on trading so as to allow settlement and adjustment. Furthermore the Listing Representative is in a position to advise the company how best to go about disclosure. Indeed the Listing Representative for the Southeast pointed out that many of the Representatives had built up a very good relationship with the senior executives of their corporations and would often be brought in at an early stage for the purpose of advising, and because of mutual respect.[502] The Exchange Company Manual provides in this respect,[503]

> 'preliminary discussion on important matters may be undertaken by listed companies officials with the assurance that extreme security measures have been taken by the

> Exchange to avoid revealing any confidential information a listed company may disclose.'

Although there is an obvious duty upon listed companies to ensure that their releases are both accurate and not misleading, the Stock Exchange does not check such or approve them. The Senior Financial Adviser to the Exchanges Financial Reporting Department informs the present author that where suspicions are aroused, the releases might well be checked, but this is certainly not routine.(504) Furthermore, as Mr. Grasso observed, in the end the truth will inevitably come out and, when it does, it will be 'hard' for those concerned with the 'cover-up'.(505)

Where there is prior notification, and the Representative has alerted the Coordinator, he will immediately alert and consult the Trading Floor Governors and Officials, and in conjunction with the Coordinator and the Director, decide upon the appropriate course of conduct. Usually a 'News Pending Hold' (NPH) will be imposed or 'News Dissemination Hold' (NDH) where the information has been disclosed but has not been digested. The Coordinator considers that usually a NDH of an hour is sufficient, but very much depends upon the facts of the case, and in particular the impact of the information and how thin the trading is. The Company Manual states,

> ' a delay in trading which normally lasts fifteen minutes after the appearance of the news on the Dow-Jones ticker, provides a period for the public evaluation of the announcement.' (506)

The Department of Corporate Liaison favours dissemination through the U.S. Financial or Reuters tapes; however, as a matter of practice, as Dow Jones is inclined to treat news very arbitrarily. For instance in one case an important corporate release came across in bits and pieces over a three hour interval. The American Bar Association in a letter of Comment to the SEC on non-public information published in October 1973, also made the point that the news services often abbreviated the news in such a way as to render it often misleading. Trading halts can last

for much longer than an hour, and have run to several weeks. 507) Under Rule 12d(2)-1 of the Securities Exchange Act 1934. where a security is suspended, the Exchange must 'promptly notify the SEC. both as to the fact and the reasons. Of course, in certain cases even though the information is highly significant, it may not be necessary to impose a hold. The officials in the Corporate Liaison Department fully realise that the 'Holds' are at best blunt instruments, and any large broker is going to be hardpressed to do more than notify a tiny proportion of his clients interested in the relevant securities, during the hold. In effect the 'holds' really only serve to afford a degree of protection to those investors who have given their brokers 'limited sell out' orders at a certain threshold.

Although 'holds' on trading are generally directed at price fluctuation they can be used for volume fluctuation. A Floor Official in his discretion may instigate a 'Buyers Influx hold' (BIH) or a 'Sellers Influx Hold' (SIH) This is significant as the automated surveillance procedures only pick up price movements and not volume, unconnected to price, here on floor surveillance is required. These 'holds' are to allow brokers and Specialists an opportunity to get their books in order and arrange matches, and to allow the Corporate Liaison Department, which will be in constant touch with the Floor, to get back to the Company and enquire if there is any known reason for the market activity. (508) Where there is something the Department will change the influx hold to a NPH.

Certain corporations because of ignorance or design, might not consult the Exchange in advance and just announce the information. The Coordinator informs the present author that where this constantly occurs, the Department would threaten suspension of the listing. Although it would seem that in general the N.Y.S.E.'s Timely Disclosure policies are reasonably well observed, the author understands from several of the Listing Representatives that there are certain instances of non-compliance which are very disturbing. The Department on occasions has felt

it necessary to advise delisting, although in fact this is rarely, if ever, actually done. There have been no cases where a company has been delisted solely because of non-compliance with the Timely Disclosure Policy, usually fraud would be the primary reasons as, for example, in the case of the Equity Funding Corporation of America. Very rarely when the Exchange is more or less certain what the material information is that the company is holding back on, it might force the issue by threatening, and indeed actually disclosing itself.(509)

During the currency of a 'hold' the Stock Exchange will put 'indicators' across the Tape. The indicators are representative quotations by specialists, and keep the market in touch with evaluation during the 'halt' in trading.

Turning now to the Division of Stock Watch or Market Surveillance, one cannot but be impressed by the degree of sophisticated computer hardware that this Division possesses. The programme is highly complicated, and here attention will only be given to those aspects of particular relevance to insider trading. At the heart of the programme is the Trading Surveillance Department which was established in late 1973. It is through this Department that the Stock List Division, through the Coordinator, the Division of Enforcement, the Division of Member Firms and the Division of Floor Procedures, are all brought together. The Departments surveillance programmes are operated on several levels. Firstly, the 'on line' surveillance programme operated by two experienced analysts of the entire market. This immediate surveillance is possible only with the sophisticated electronic aids that the two analysts have access to. Television Scantlin Display Units are locked into the N.Y.S.E's Mainframe IBM Computer, and the 'on line' investigators can monitor simultaneously a variety of 'on floor' trading activities. The screen which each investigator has, and which is more or less watched continuously during trading, is divided into three View Bands.

Through the top band the complete Tape of all trades on the exchange Floor, plus a selected tape of thirty or forty stocks, that the Stock Watch Programme want to keep a particular eye on, are presented. On the second band there is the Dow-Jones Tape, and a running record of the days block trading. Finally, there is a band for the Reuters Tape and room for the investigator to retrieve and scan all current transactions and data on a given stock or group of stocks for any trading period that he may choose. Both 'on line' investigators, Mr. Frank Rosana and Mr. Peter Ionello assure the present author that there are few, if any, transactions that could go through without at least one of them seeing it. (510) A similar system is also available to the Corporate Liaison and Market Surveillance Coordinator in the Stock List Division. Apart from acting as a back-up this system is utilised by the Coordinator to focus down on to a particular security or related group of securities.

The second level, and a particularly important one, is the automated surveillance programme. Every listed issuer is programmed into the computers with set parameters on its stock. These parameters are based on normal trading patterns. (511) When a transaction exceeds these parameters the computers instantaneously 'kick it out'. These 'kick outs' are printed by the computers with the particular symbol, the price, and the exact point in time that the transaction occured.

On the N.Y.S.E. all transactions have to be reported and go through the tape (512) and will thus be recorded in the computers. Immediately a bargain is made on the Floor a Stock Exchange Reporter will mark the relevant details on an IBM Computer card and feed it straight away into a clearing terminal situated at each trading post. Within seconds the transaction will come across the Exchange Tape and all other connected and relay tapes. (513)

As soon as the parameter violations are printed out as 'kick outs' they are scrutinised by the 'on line' analysts and generally immediately referred to the Manager of the

Market Surveillance Department. Of course in many cases the reasons for the 'kick out' will be obvious to the 'on line' analysts and, if necessary, then can take the appropriate action immediately. The Trading Surveillance Department also possesses detailed and files on listed companies and has a number of researchers trained to do preliminary searches for the 'on line' investigators. In those cases where a ready explanation cannot be found the investigators will contact the Coordinator, who would probably already be on to the matter, and the relevant Listing Representative.

The Coordinator informs the present author that the number of 'kick outs' is on the increase, and on average there are several dozen each day, although it would seem out of these only five or so are not immediately explicable. As has already been mentioned, where the Listing Representative is given advance warning of an impending release, the Coordinator will notify the 'on line' investigators so that they can keep a special look out for that security.

When a report is made to the Corporate Liaison Department the relevant listing representative will contact the corporation concerned, and under the terms of the listing agreement, the company is obligated to cooperate fully with the Stock Exchange in trying to determine why normal trading has occurred. [514] The Coordinator and Representative for the Northeast rather cynically observed that in 98% of cases the corporation flatly denies that there is any question of informed dealing by insiders and their privies. Certainly the 'on line' analysts consider that the vast majority of fluctuations are not the result of insider information, but outside or market information. [515]

The third surveillanceprocedure is that operated on the Floor of the Exchange by the Floor Officials and Governors. They are particularly concerned to identify unusual trading patterns, crowding and the possible abuse of market information. The computers on the N.Y.S.E. are not set for volume fluctuations, although such does appear on the tapes. Thus the Floor Officials play an important role in identifying such. Although under the N.Y.S.E's rules all rumours must be immediately notified to the Exchange, this

is not always observed and thus the Floor Officials and also the Specialists play an important role in picking these up and reporting them to the Stock List Department and Market Surveillance.

Where the Stock List Department of Market Surveillance Department cannot find an explanation for the unusual price or volume movement, the Market Surveillance Department will start an investigation. The Department has seven Investigators, including a Chartered Financial Analyst, and a Financial Supervisory Analyst, an Accountant, a former Branch Manager of a large securities firm, a former registered representative, a former Floor Trader and a Lawyer who was a Compliance Officer in a large corporation. In addition, there are five Attorneys under a Chief Counsel. There are also people running the computers, secretaries and clerical assistants. Furthermore, there is a considerable degree of interfacing and cooperation with other Departments and Divisions, in particular the Stock List Division through the coordinator.[516] The Senior Staff Attorney was also at pains to emphasise that there is also a considerable degree of cooperation with the SEC. particularly through the New York Regional Office,[517] and the other self-regulatory authorities.

Initially the Department has to decide whether the fluctuation is more likely to have been the result of an abuse by a member firm or by a member of the investigating public. If it appears probable that a Member firm is involved and at fault, the matter is handed over to the Division of Enforcement. This is a much larger Division, having a staff in excess of fifty persons, with some thirty-five of them being lawyers. This Division is concerned with the enforcement of Stock Exchange rules and does not generally concern itself with investigations, although it does occasionally assist in such. There is little doubt that the Market Surveillance Department likes to find a violation of the Rules, as this makes the investigation so much easier, as the Division of Enforcement can come down upon the Firm concerned and obtain a degree of cooperation that it would normally not

be possible to get. Both the Chief Counsel and the Senior Staff Attorney assured the present author that whilst there were no rules specifically on insider trading by member firms, Rule 435(5), which has already been mentioned, is interpreted as doing just this, and placing an obligation upon members to report all sensational rumours, which includes inside information, to the Exchange immediately it hears such.[518] Moreover, the N.Y.S.E. considers that the Federal Laws outlawing insider trading, would afford them sufficient grounds to investigate and discipline its members.

In the case of a suspected trading abuse by a non-member, which will of course be the more usual case, the Director and Manager of the Department in liaison with the Stock List Division will on the basis of preliminary trading scans, provided by the computer section, determine the period through which a closer investigation should be made. The N.Y.S.E's permanent records in the 'Journal of Transactions' can be used with the comprehensive lists prepared by the Emery Francis Finch Inc. to provide a list of all trades, in transactional order, the details of the transaction and the broker concerned. The investigators can then approach the brokers and obtain details of the clients concerned, and whether the order was solicited or unsolicited. Once the name of the client is obtained then the investigators, by consulting Standard and Poors Business Records, the N.Y.S.E.'s own records and Section 16(a) filings, tell whether the particular individual had any contacts through which he might have obtained inside information.[519] The Division has on occasions asked customers to appear before the investigators[520] and be examined by the Attorneys. These statements are generally unsworn and voluntary. It seems that it has been the Departments experience that people generally cooperate fully with it, unless of course they have something to hide. Where the person concerned is an insider of a listed company, the Department will not be adverse in exerting pressure on the company through the Stock List Division to persuade the insider to be more cooperative.[521]

The Department investigators do cooperate with officers from the SEC and State Blue Sky authorities, as well as the other self regulatory authorities. Certainly if the Department considers that there has been a violation of the securities laws, it will hand the report over to the SEC as it did recently in the L. & M. Tobacco Company case. It is likely however, that the SEC will have been brought in at a much earlier stage in such cases. It is obviously an advantage for the investigators to be able to appear to be working with the SEC. or at least being in touch with such. The investigations can be very wide ranging and have gone as far as Indonesia. (522)

The Department acknowledges that the presence of nominees can cause great problems with regard to identification. The Manager of the Department described foreign nominees, both banks and financial institutions, as well as private individuals as 'dead ends', and added that the SEC doesn't get much further. (523) With regard to domestic nominees there is not the same degree of difficulty as here the N.Y.S.E. will simply rely upon the 'know your client' rule. The N.Y.S.E. interprets this as placing an obligation upon member firms to know who their client actually is. Thus the onus of identification is transferred on to the member firm. Thus Member firms make sure that they know who their client is when they take his account on in the first place. Furthermore Member firms generally can get to the facts in a way that the regulators would not be ableto. Of course this does place a very great burden upon member firms, and although no firm has yet been disciplined for failure to find out the true identity of ohe of their 'clients' the prospect is always there. The Stock Watch programme is also used to test the market once a trading halt is lifted. Here there will be close cooperation with the Floor officials and the Stock List Department to see whether the market can be allowed to 'run'. It should also be mentioned that the Department will act upon complaints made to them about dealings in a particular security over a particular period of time. Indeed the present author understands that the Department receives a considerable number of such enquiries

each year from a wide variety of sources. The SEC foreign Governments, and not least, the issuers involved, are among these. The N.Y.S.E.'s surveillance is by all standards impressive. The officers concerned are experienced and of a very high calibre. Indeed the dimension of the programme underlines the importance that the Exchange attaches to the maintenance of proper market surveillance. On the other hand nobody would argue that the machines are infallible, and there have been technical problems. It is surprising that the automated surveillance does not register volume parameters, as it is understood that this would require minimal alterations to the programming. Furthermore, the Journal of Transactions is not immediately available and there is a time lag of about 5 hours whilst it is prepared and, more to the point, it does not list the trading broker who must be identified from the Emery Francis Finch Inc. Lists by a process of cross reference which is not always accurate. It must also be doubted whether the Exchange can always get to the bottom of an investigation by applying pressure upon member firms. In a letter to the SEC. from Representative Charles A. Vanik, concerning his request for an SEC investigation into dealings in Abbott Laboratories, the Representative referred to the fact that a spokesman for the N.Y.S.E. had admitted that the Exchange had no way of finding out and, 'did not have the authority to find out' who had traded two large blocks of securities, both in excess of 50,000 shares, prior to the announcement of the material information. (524) Also whilst many in the N.Y.S.E. deny it, one cannot help feeling that in certain instances there is a reluctance to disclose because of possible liability in defamation.

It is interesting that the N.Y.S.E. systems of surveillance have attracted considerable attention in recent years. The Deputy Secretary of the Department of Trade, the Principal of the Companies Policy Division, the Parliamentary Under Secretary of State for Companies, Aviation and Shipping, and the Director General of the Takeover Panel have all been shown around the Department, with the British Ambassador, during the last eighteen months.

(b) THE AMERICAN STOCK EXCHANGE

After the Re affair in the early 1960s, the SEC staff Report on the Organisation, Management and Regulation of Conduct of Members of the American Stock Exchange,(525) found the dificiencies in regulation' goes beyond isolated violations, and amounts to a general deficiency of standards and a fundamental failure of controls'. The American Stock Exchange immediately commenced a drive to tighten up its self regulation and surveillance procedures. The present mechanism for stock watch is basically similar to that operated upon the N.Y.S.E. although not so extravagant.

The American Stock Exchanges Securities Division has a staff of listing representatives similar to that of the Corporate Liaison Department in the N.Y.S.E. The Exchanges Disclosure Policy emphasises that these officers are intended to develop and preserve intimate contacts with the particular companies in the group for which they are made responsible. (526) Each representative has direct telephone contacts with the relevant floor official; the division of issuers not being on a geographical basis, but by industry. Each representative is also in direct contact with the Market Surveillance Department. There is no Stock List and Surveillance Co-ordinator. (527) The American Stock Exchange's Disclosure Policy underlines the critical position of the Listing Representative in evaluating disclosure as and when they arise. The corporation should consult the representative as much as is practicable, and unlike the N.Y.S.E. there is an express duty upon issuers to alert the representative prior to the disclosure of information during trading hours. (528)

Supervision of the market and the Exchange's Members is carried out primarily by the Market Operations Division, and the Legal Compliance Division. (529) The Stock Watch programme is in the hands of the Department of Market Surveillance however, which is part of the Legal Compliance Division. The entire programme is under the control of Mr.Frank J.Savarese, an Assistant Vice President of the Stock Exchange. The Department consists of Mr.Savarese who is a well-known expert on stock market surveillance programmes, seven clerical and secretarial assistants and

six professional officers. This latter category includes an Accountant, an Analyst and an ex Broker. There are no lawyers in the Department as the Department is solely concerned with the isolation and identification of abuses, and compliance and enforcement is dealt with by the Division as a whole, which does possess a number of Attorneys.

The market surveillance programme operates on the basis of a number of 'imputs' of information, upon the basis of which the Department tries to identify irregular trading patterns. Firstly, there are the tapes upon which market transactions appear and are recorded within a few moments of their execution. The tapes are watched more or less continuously through Scanlin screens which are set into the main computers, similar to those at the N.Y.S.E. and which can retrieve and present on the screens past transactional data. Secondly, the Department maintains large and comprehensive files on all its listed issuers, which are constantly being updated by the insertion of information from the media and tapes. Apart from allowing members of the Department to detect likely movements in the securities prices, this also allows the Department an immediate system of reference. Thirdly, as with the N.Y.S.E. a careful watch is kept on the various new tapes for important developments. The American Stock Exchange operates News Pending and Dissemination Holds in much the same way as does the N.Y.S.E. Fifthly, the computers are programmed along the lines as those already mentioned possessed by the N.Y.S.E. It is important to note that the American Stock Exchange computers have both price and volume parameters however.[530] The American Stock Exchange computers do not however, immediately isolate and 'kick out' devient trading patterns, but the 'exceptions' are printed out by the main transactional computers at the close of every trading session, and listed in an 'exceptions Report' which is forwarded to the Market Surveillance Department for the following day. Of course, 'on line' surveillance and detection of these transactions is possible from the tape. Sixthly, there are some 28 Floor Officials on the actual trading floor who are in constant contact with the listing representatives and the Department of Market Surveillance.

Indeed four floor officials are particularly designated to conduct on-floor surveillance throughout trading.[531] The American Stock Exchange considers that on-floor surveillance is very important. Seventhly, the Market Surveillance Department often receives enquiries from the corporation, the general public and member firms. A large proportion of enquiries from the public are anonymous and often turn out to be mere suspicion rather than fact. Nevertheless the Department does attempt to investigate and check out all reported cases. Finally, the Department has the opportunity of detecting whether an undue proportion of the market in a given security is taken by a particular firm, through the Exceptions Report. Generally, it may be possible for the price of a security to remain within the parameters, even though there had been important corporate developments if all the trading was concentrated in the hands of a particular firm. The price of a security may remain quite steady whilst a very high proportion of all purchases in a given period were effected by a single firm perhaps having the benefit of privileged information. This has also allowed the Department to detect fictitious transactions in options for the purpose of influencing the market price on the tape.[532]

When unusual market activity is detected it will be immediately reported to the relevant listing representative, who will often be in a position to give an opinion as to whether it is likely that an impropriety has occurred. If the listing representative cannot give a satisfactory explanation, the Market Surveillance Department, often through the Floor Officials or the Membership Department, might approach the individual brokers and ask them if they know of any reasons for the particular unusual trading pattern. If still no source is found the listing representative will approach the issuer and request assistance in isolating the reasons. This assistance is not always forthcoming. For example, in the merger negotiations between Geon Corporation and Burmah Oil, the Market Surveillance Department detected an imbalance to sell orders and suspended trading. The listing representative contacted

Geon and enquired whether there was any material undisclosed information in their possession. The Financial Officer of Geon had recently learned that the company's profit estimates were overstated, but on legal advice denied that there was material undisclosed information available. Two days later Geon made a public announcement of the shortfall, and that Burmah Oil had terminated the acquisition programme. It is surprising that whilst the American Stock Exchange with some justification, felt that this was a breach of their Timely Disclosure Policies, the District Court for South New York rejected the allegation that Geon had been guilty of misrepresentation under Rule 10(b)(5) as 'Geon only had raw unverified information which might have been misleading had it been made public. Moreover it is significant that the officer sought and followed the advice of counsel in telling the American Stock Exchange that the company would have no public announcement to make'.(533)

Where it proves impossible to trace a reason for the irregular trading, or where it is thought necessary to determine who exactly was trading, the Market Surveillance Department, in conjunction with the Legal Compliance Division will attempt to reconstruct the market. This reconstruction will be achieved by utilising the Transactions Journal compiled by the Exchange, which contains the chronological order of transactions, the price and volume of each transaction, and also the Daily Clearance Sheets prepared by Emery Francis Finch Inc. as do the N.Y.S.E. investigators. The Daily Clearance Sheets identity the brokers and the shape of the transaction. Thus neither the American Stock Exchange nor the N.Y.S.E. has yet effected a procedure whereby the market, on a given day, can be easily and accurately reconstructed so that all buyers and sellers can be identified. And further each Exchange has difficulty in determining exactly at what time the broker traded. If the market is consistently expanding or contracting, it is possible by matching the Journal and Daily Clearance Sheets to fix at what time a particular Member traded, but where the prices are fluctuating it is exceedingly difficult to obtain a satisfactory match. The only viable way to pin point the time of a

particular transaction in an active two-way market, is to obtain the Order Tickets from the particular Member firm. All firms are required to keep these tickets for at least two years. Nevertheless whilst in the majority of cases it is possible to trace the relevant brokers and table the time that the relevant transaction occurred, there are practical problems and it does not always follow that identification will be possible.

Once the names of the transacting brokers are discovered the Department will contact them and ask them for details as to their clients. There is, of course, the major difficulty of nominees, and again the Exchange relies upon the 'know your Client' rule. Indeed Mr.Savarese informed the present author that

> 'one of the questions that we expect a broker to be able to answer if we happen to ask, is the identity of his client. By this we mean his name, address, employer, occupation and any connections that he might have with listed companies'. (534)

The Market Surveillance Department does consider that it is reasonably successful in finding possible sources. Certainly where the transaction is placed through several brokers, the Exchange would expect the brokers to be particularly careful and searching. Where the Department and the Attorneys from the Legal Compliance Division cannot discover any tangible contacts, the Department will send the names of the principals to the company and ask if it is aware of any contacts with such. The Department will exert considerable pressure upon a corporation to co-operate fully here, and suspensions have been threatened on several occasions. Where there was a blank wall, particularly where financial institutions were involved, the Department might request assistance of the SEC. However, Mr. Savarese was sceptical as to the success of this. Where there was not a formal order of investigation, the powers of the SEC were usually less effective than the de facto powers possessed by the Exchange. Where foreign nominees were involved the investigation was invariably frustrated.

The Department on average uncovers three or four cases of significant insider abuse each week on average.

Each day however several abnormal trading patterns will be encountered. The lengths to which the Department will go in following these up will depend upon a number of circumstances. Where the transaction is small and appears an isolated occurrence the Department does not bother over much, but the attitude of the Department is very different where thousands of shares are involved. If it appears that the irregularity involves a member firm a report will be made to the Membership Compliance Division, and the investigation would be handled by the Attorneys of that Division, occasionally with the assistance of lawyers from the Legal Compliance Division. Where the irregulatory involves outsiders the matter will usually be passed to the SEC or some other regulatory authority. On average every three weeks the Department forwards an insider trading case to the SEC, but apart from this the Exchange has adopted a policy of alerting the Commission to the merest suspicion of abuse, and invariably does not wait until a final report has been prepared. There would seem to be a considerable measure of frustration, if not disgust, with the SEC's general apathy or laxity of approach in the Department and Division as a whole. In particular the Exchange is concerned that in proven cases of significant insider abuse the SEC will settle for a consent injunction, which is nothing more than 'a slap on the wrist and a promise to be good, or at least not get caught in the future'.(535) Whilst Mr Savarese, does sympathise with the SEC to the extent that its enforcement programme is short of both staff and resources he considers that the present 'easy approach' turns regulation into a 'sham'.(536) Indeed he doubted whether more than a small proportion of the reports sent to Washington were even considered.

Feeling somewhat let down by the SEC the American Stock Exchange attempted to devise its own procedures to deal with proven insider traders. Over the last four years the Exchange has sought to utilise its substantial powers over listed corporations to apply pressure upon corporate insiders. Once an investigation has identified an insider, the American Stock Exchange will attempt to persuade the insider to cancel the abusive transaction if the innocent party so desires.

Ironically there have been cases where the victim thinks that having been caught once by the insider, the insider might 'know something else' and thus tender recision, so he rejects the insider's 'offer'. Once a recision has been effected or at least tendered, the case will then be forwarded to the SEC. The procedure adopted by the Department is described by Mr.Savarese -

> 'We go along to the issuer and tell them that their executive Vice President was dealing, on such and such a date, on the bases of what later appeared to be inside information ... Often they defend him and say that he did not have access to it, or has a clean record. We generally ignore this! We discuss it all with them and suggest, often outright, that we think that nonetheless the case is fishy and looks bad and that publicity would do no one any good. We will then work on them, remind them of the possible civil liability that could fall upon them, and at the end of the day we find that we have 'persuaded' them to 'ask' the Vice President to make an offer of recision. We then get the Corporation to agree to fire the director if he doesn't agree to co-operate'. (537)

After this the Department will generally see the director concerned and explain that to comply with his company's ultimatum he must get his broker to offer recision to the other party.

Of course whilst this does deprive the insider of his ill-gotten gains, the procedure is fraught with difficulties. The Exchange admits that as a last resort it would seem unwise to suspend or delist, as this only harms the investor and the market, and the reason for the suspension would be unconnected to the market in the issuers securities. Nonetheless whilst corporations feel that the Exchange might just do this, it does have an interim effect. It is interesting that Mr. Rick Norell, the Chief of the SEC's Market Surveillance Office, informed the present author that there was a lot of 'unofficial' support in the SEC for the American Stock Exchanges approach. It certainly got results in his view.(538) In fact he regretted that as a Government Department the SEC could not itself really adopt such tactics.

The position with regard to specific rules against

insider trading on the American Stock Exchange is the same as that on the N.Y.S.E. There are no rules specifically directed to the misuse of such information, and primary reliance is placed upon the general law and the provisions that the Exchange has on the avoidance of false markets and rumours in its rules. The American Stock Exchange in cases of proven insider trading by its members usually relies however, upon Rule 16 of its Rules and Regulations. This places an obligation upon all members and their employees to at all times adhere to good business practice. Insider trading is, of course, violative of such a standard.

Finally, it should be pointed out that the American Stock Exchange has been responsible for the main pioneering work in the field of stock market surveillance or stock watch, more so than the N.Y.S.E. Indeed, in programming the smaller American Stock Exchange is ahead still of the much larger and more prestigious N.Y.S.E. It is interesting that in the last couple of years representatives from Venezuela, France, South Korea, Canada, New South Wales and Germany, have all been sent to examine the American Stock Exchanges surveillance programmes.

(c) NATIONAL ASSOCIATION OF SECURITY DEALERS (NASD)

In recent years the regulation of the very important Over-the Counter securities market in the United States, has attracted considerable attention.[539] This is an amorphous and fluid market, without a ticker tape and no public record of transactions. Bid and asked prices by various dealers who are interested in making a market in a particular security, are generally circulated through the National Daily Quotation Service.[540] Broker-dealers utilising interstate facilities must register with the SEC under Section 15(a)1 of the 1934 Act, and rule-making power is given to the SEC concerning conduct and suitability for registration.[541] The SEC has considerable disciplinary authority over registrants and their personnel.[542] This regulatory scheme was supplemented in 1938 by the Malony Act which added Section 15A under which the National Association of Security Dealers was recognised as a self-regulatory agency with similar powers and responsibilities as the national securities exchanges.[543] Membership of NASD is not however obligatory, and prior to the amendments of 1964 there was a major lacuna in the regulatory scheme for those registered dealers who did not seek membership. After 1964 these dealers who are not NASD members are bound by the SECO provisions drawn up by the SEC. which are basically similar to the rules and regulations of NASD.[544]

One of the main requirements for registration as a self-regulatory organisation under Section 15A, is that the rules of the organisation 'must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits ... and in general to protect investors and the public interest and to remove impediments to, and perfect the mechanism of a free and open market ...[545] The NASD is governed by its Constitutional Bye Laws, Uniform Practices Code and from our present point of view most importantly, the Rules of Fair Practice and a Code of Procedure for Handling Trade Practice complaints. NASD is alert to the need to ensure a

high degree of public confidence in the over-the-counter market, for example, the Board of Governors in the NASD's Manual emphasise,

> 'Implicit in all members and registered representatives relationship with clients and others is the fundamental responsibility of fair dealing.'

In another policy statement the Governors have made it clear that they and the District Business Conduct Committees of the NASD will take disciplinary action wherever 'complete fair dealing is not observed'. In Article III, paragraph 18 of the Rules of Fair Practice, it is provided

> 'No member shall effect any transaction in or induce the purchase or sale of any security by means of any manipulative, deceptive or other fraudulent device or contrivance.'

The Board of Governors have made it clear that this would extend to misuse of confidential information, from an insider or indeed a market source. (546) Under paragraph 13 an obligation is placed upon broker dealers to disclose to their clients any interest or connection that they may have in the issuer of the securities concerned. There are a number of other rules relating to anti-fraud (547) and although there is no specific provision dealing with insider trading, apart from paragraph 18, the NASD take the view that such conduct would be contrary to the paramount rule of fair practice in paragraph 1. that ' a member in the conduct of his business shall observe high standards of commercial honour and just and equitable principles of trade.' The NASD reinforces these rules by a relatively strict system of inspection which has been greatly strenthened in recent years. It is important to note that, as with the Stock Exchange rules, members representatives and associates must be registered and undertake to abide by the various rules. Furthermore, under Article III. paragraph 27. an obligation is placed upon each member to establish written compliance codes for its staff, and to enforce such. Very important here is the detection of insider abuse by personnel of members. A particular partner or senior officer of the Member firm must be

specifically delegated to supervise this internal compliance and must also ensure that proper records are kept. In particular 'each member shall review and endorse in writing, on an internal record, all transactions and all correspondence of its registered representatives pertaining to the solicitation or execution of securities transactions.' (548) Under paragraph 27(d) 'each each member shall review the activities of each office which shall include a periodic examination of customers' accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction.' (549)

Section 15A(b)9 of the 1934 Act places an obligation on the registered organisation to provide 'fair and orderly procedures' for the disciplining of its members. Under the NASD rules anyone can file a complaint with a District Business Conduct Committee, although in most instances the Committee will act of its own initiative. There is an obligation upon all members to ensure fullest cooperation with these Committees. The investigation will be conducted by the Secretary or another member of the Committee's staff or a special sub-committee of the Committee. The Committee can impose a wide variety of sanctions including suspensions, expulsion and fine. The decision is reviewable by the Board of Governors, with a further appeal to the SEC. and then to the relevant U.S. Courts of Appeal. The NASD has not been slow to utilise its extensive powers. It should be noted however, that the SEC cannot take direct action against a member for failure to comply with the NASD rules, although, of course, if there is a violation of its own rules or the Securities laws, it can proceed directly. The SEC can always apply pressure to the NASD by threatening suspension or cancellation of their registration for a wilful refusal to carry out their duties.

The Special Study of the Securities Market emphasised that the regulatory effort was deficient largely because of the lack of any organised communication system between trading firms and the absence of anything approaching a tape. (550) The NASD thus began to consider the introduction of a computerised transaction system. In 1967

NASD retained the Arthur D. Little Company to study feasibility of a new system and the result was the implimentation of the National Association of Securities Dealers Automated Quotations, or NASDAQ. This is a nationwide computer communication system constructed and owned by the Bunker-Rama Corporation.

Market makers regustered as such in a particular security with NASD will haye in their trading rooms a special television screen which will display, on request, a list of all market makers and their current quotations. The market maker will also have a terminal keyboard with which he can enter into the quotation system. To be listed under NASDAQ the securities must be registered under Section 12(g) and all told some 3,100 stocks are carried. The service that NASDAQ provides is essentially threefold.(551) Firstly, there is a level designed to provide the individual investor with information through his retail broker. This service takes the quotations of all dealers making markets and relays current, constantly correcting representative bids and asked prices. This is a median quotation of all individual quotations. This representative quotation is relayed to over 30,000 display units. The second level involves specially designed terminals with television screens designed to serve in particular retail broker-dealers and large scale professional traders, such as institutional investors. On activation the screen will present the current quotations of market makers in a particular security. The quotations of only five market makers ranked according to the best prevailing bids or offers at the time, are displayed on the screen, and if there are more they can be retrieved and presented in groups of five. It is important to note that NASDAQ is only a quotation service and not a trading system like ARIEL. Once the quotation has been received then the market maker still has to be contacted by wire or telephone and the transaction negotiated. The third level which we have already mentioned is that of the market maker himself with his own input terminal.

The NASD consider that one of the most important features of the new system is that it 'brings visability

to the over-the-counter market and people who know what is going on becuase they can see it.' (552)
Within a few months of NASDAQ's introduction, price indices on general segments of the market were prepared and released, now the NASDAQ OTC Prices Indices are available over the NASDAQ system, where they are updated every five minutes. At the end of each trading day each market maker is required to feed into the central computer details of his total volumes in each stock in which he has traded and is registered as a market maker. This is then compiled and published daily giving the total volume of each security within the system traded. These figures are also released directly to the wire services.

Prior to the introduction of NASDAQ, although the NASD would on rare occasions enquire into fluctuations in market makers quotations if they are aware of such, there was nothing really approaching continuous market surveillance. It is also important to remember that there is no listing agreement between the companies whose securities are traded on the over-the-counter market and the NASD, or even the NASDAQ system, although NASDAQ only carries securities within the scope of Section 12(g) and thus subject to the Federal Disclosure requirements. The NASDAQ Market Surveillance Department is relatively new, having been in operation for only a few years. The staff consists of a manager who is currently an eminent computer expert, an analyst, two senior analysts, three group analysts, three clerks and a secretary. Where the market becomes more active the NASD will supply additional officers from other Departments. In addition to the Market Surveillance Department there are some 14 District Offices, each having full time officers concerned with enforcement and also surveillance. There are a further 400 Examiners working throughout the U.S.A. Of course, District Officers and Examiners are primarily concerned with observance of NASD rules and the laws by members, whilst the Market Surveillance Department is concerned mainly with the preservation of a fair and orderly makret. In both cases however, there is a considerable degree of overlap and liaison. (553)

The Market Surveillance Department also relies to a considerable extent on the computer staff responsible for the running of NASDAQ computer system. These people are however, employed not by NASD but by Bunker-Ramo. The Department also requires cooperation from the other self regulatory agencies and also the SEC.

Although the Department and also member firms obviously use the Dow-Jones and Reuters, they are not well suited to the generally smaller corporate issuers on the over-the-counter market. Indeed smaller companies have a considerable problem with effecting timely disclosure, as the media and wire service editors are reluctant to carry their disclosures at least as a matter of urgency. (554) Thus NASD have sponsored two separate news relays paid for by subscribers and the issuers on the market. The Market Surveillance Department has about six tapes to watch as a consequence of this, as well as the general media. It attempts to build up detailed files on particular over-the-counter issuers, as do the national securities exchanges.

Once member firms have transmitted their trading details to the central computers at the close of trading, the computer staff prepare Securities and Regulation Reports which are relayed to Washington and printed out for the Market Surveillance Department by 9 a.m. the next day, an hour before trading starts. The Department will then examine all price changes recorded in these reports that have effected the representative price. Of course, it may well be possible for a market maker to alter his quotation by a point or so, and this will not necessarily alter the representative price. The computers will still identify this and immediately relay details to the Department which will check it out as a matter of routine immediately, and not wait until the following morning. The Securities and Regulation Reports identify all changes in the representative price, no matter how small. It should be emphasised that unlike on the national securities exchange the surveillance data is complete and it is possible to retrieve from the computers the quotation and exactly what market makers made it, the

the Securities and Regulation Reports, the relevant quotation which effects the representative price and who made it, and at what point of time will all be recorded. In addition there are also 72 price and 12 volume parameters individually tailored to the performance of the particular security. Securities are grouped into dollar equivalent bands and the parameters fixed upon these.[555] The volume parameters are set with reference to annual trading performance actual, or where necessary, estimated. Although the Securities Regulation Report will identify all parameter violations, the computers will alert the Department of Market Surveillance as and when they occur, and they will thus be examined in most cases immediately. As a matter of practice the entire Securities Regulation Report is not required by the Department and generally only those changes which effect the parameters, or have a significant effect on the representative price, are retrieved and printed out, at least in the first place. There are some 140,000 price movements on an average trading day, but there will generally only be about 50 significant parameter violations. On average the Manager informs the present author that there are between 250 to 500 parameter violations in a week. The Department's analysts will also examine the Reports closely with the intention of discovering less ovbious price and volume movements. In the result about 20 to 30 cases a day are isolated as requiring further scrutiny. Attempts will be made to match the price or volume fluctuations with items of news from the tapes or from the press, and this will primarily be the responsibility of the research clerks in the Department. Where no ready explanation can be found, the Department may well contact the issuer concerned and enquire whether there were any material undisclosed developments. The analysts who conduct the investigation may also ask the issuer to find out whether any of its insiders traded during the relevant time and whether it was likely that they were in possession of material non-public information.

The investigators invariably also contact the market makers and request details of their clients, and whether they were aware of any reasons for the inbalance. Whereas the issuers cooperation is entirely voluntary, members of NASD are bound under the Association's rules to provide all necessary assistance. Where the Department considers that there are suspicious circumstances, or is not satisfied that a reasonable explanation has been found, it will instigate a review of all transactions in the relevant securities during the period of time in question. Once a 'study period' has been selected questionnaires will be sent out from the Market Surveillance Department to the market makers, and then on the basis of their replies to the customers. The Manager informs the present author that there is invariably a high degree of cooperation. Of course it is necessary to bear in mind that NASDAQ only has a record of the quotations and not the resultant transactions.

It is interesting that NASD operates a 'know your client' rule similar to that of the national securities exchanges. Where full lists of clients are obtained, the Department then tries to determine whether any such client probably had possession of inside information or market information. The Department does keep lists of corporate insiders in its traded issuers, and will often supply the clients names to the relevant corporation asking such to identify any known insider connections. If a NASD member is involved the matter will be referred to a District Business Conduct Committee. Where it appears there has been an abuse not exclusively involving members of NASD, the Market Surveillance Department will refer the case to the SEC. The NASDAQ Market Surveillance Department works in reasonably close contact with the SEC Market Surveillance office, and there appears to be a healthy mutual respect between the two. The SEC recognises that it would not have the resources to maintain the kind of programme that the NASDAQ Department operates, and generally takes the view

that self-regulation works better here than regulation from outside the industry by civil servants. An Attorney in the NASD Division of Enforcement and the Manager of the Market Surveillance Department are of the opinion that insider trading is and always has been a prevalent abuse on the over-the-counter markets. Indeed the Manager thought that if anything, the abuse was on the increase.(556) On the other hand the Manager admitted that NASDAQ were now better at isolating the abuse, and thus it was the proportion of detected cases that had increased rather than the abuse in general. Given the bad state of the market and the general feeling it was impossible to 'get rich honestly' and the quantity of corporate failures, and profit cut-backs, all of which produced considerable amounts of inside information, the Manager considered insider abuse was inevitable. The Department has been successful in a number of cases in isolating this abuse, and has even surprised some of its most vehement critics.(557) There is a frustration with the lack of support that it gets from the enforcement programme of the SEC.

(d) THE SECS OFFICE OF MARKET SURVEILLANCE

The SEC possesses considerable investigatory powers, but here we are concerned specifically with market surveillance. The present Office of Market Surveillance, which is situated in the SEC's main office in Washington, originally grew out of the SEC's Division of Trading and Exchanges. There was growing concern that the SEC should extend its involvement to detection rather than waiting for complaints to be made to it and then instituting an investigation. The SEC thus adopted a proceedure under which officers in the Trading and Exchanges Division, and in the Regional Officers would monitor the various stock exchange tapes, and examine the NASD's Daily Quotation Sheets whilst maintaining surveillance over the news tapes and media.[558] Where the SEC detected a suspicious movement, the relevant Regional Office would instigate an investigation invariably informally without publicity. Where the matter was not 'cleared up' the SEC might well make a formal order of investigation. It would seem that on average over 100 of these preliminary investigations were conducted each year.[559]

This procedure had obvious defects, not the least being the lack of coordination and deficient resources. In an attempt to up-grade surveillance, the Office of Market Surveillance was set up within the SEC'S Division of Enforcement. This Office, although primarily responsible for market surveillance, does liaise and cooperate with other Divisions and the Regional Offices. Thus before discussing the Office's stock watch programme, it is worth mentioning the surveillance operated by the Regional SEC Offices.

The most important Regional Office, that in New York, should have a surveillance staff of four financial analysts and a surveillance assistant administering its local stock watch programme. However, because of a shortage of staff, or rather the money to pay them, there is only the Chief Regional Administrator himself, and another analyst, both of whom have other considerable responsibilities administering

the entire programme.[560] It is probable that similar deficiencies exist in other Offices, for example, when the Director of the California Insurance Commission reported large scale frauds involving the Equity Funding Corporation of America, including insider trading abuses, to Mr. Lee Ogg, the Chief Attorney at the Los Angelos Regional Office it was three and a half weeks before the SEC looked at it.[561] Washington had been given the same information three years earlier!

In theory the Regional Offices are supposed to monitor the tapes of their local exchanges and check out reports submitted to them from the various self-regulatory agencies. The Chief Regional Administrator for New York informs the present author that occasionally the Office will check out an abnormal trading pattern, but this was really 'only as a matter of curiosity'. Volume fluctuations that did not effect price would not, in his view, be detected in the first place.[562] The Office does keep reasonably detailed files on locally listed issuers, and clerical assistants are detailed to keep these permanently up to date. This can be most useful should it be necessary to check something out.[563] The Chief considers that at most the Regional Offices can cooperate and occasionally back up the local self-regulatory authorities, and investigate specific cases sent down to them from Washington.[564] It is interesting that the Chief and also the Associate Regional Administrator at the Boston Regional Office[565] thought only the small cases of insider abuse got past the self-regulatory surveillance programmes and what backup the SEC had. The same situation would appear to pertain throughout the Regional network.[566]

The Director of the Office of Market Surveillance in Washington, likewise is under no delusions about the critical significance of the self-regulators surveillance programmes.[567] At best the SEC's procedures are only a 'back-up' or overview. This is an important fact, as the limited resources of the SEC Market Surveillance Office could do nothing more than this.[568] The Office only has fifteen trained officers to monitor all the securities markets in the United States.

The SEC's surveillance programme, like those operated by the self-regulatory authorities, is at several levels. Firstly, the Office, in conjunction with other Offices and Sections in the SEC, will check insiders reports under Section 16(a) and reports under Section 13(d). Secondly, the Office maintains copious files on virtually all registered securities, which are constantly being up-dated. Thirdly the Office works in reasonably close contact with the surveillance personnel of the various self-regulatory agencies. This includes the receipt of stock watch reports, which are then examined and a decision reached as to whether there is a need for further enquiries.[569] Fourthly, the Office maintains, at least in theory, a continuous watch over the tapes of both the NYSE and the American Stock Exchange. It is perhaps ironical that the personnel in the Market Surveillance Departments in these Exchanges think that the SEC does in fact run a complete and thorough check of their own surveillance programmes. In fact this is very far from the truth. Whilst the Director of the SEC's Office thought that this was a good illusion to preserve, he emphasised that the Office would definitely not have the technical and personnel capabilities to do this. In practice the SEC merely keeps an eye upon the news tapes, and when something significant comes through, looks back at the Exchange's tapes previous to the disclosure. The SEC has developed a fully automated surveillance programme for the over-the-counter market however. The Sec's computers are very similar to those used by the Stock Exchanges and NASDAQ. They are set for parameters fixed daily upon the basis of an analysis of the previous days trading. The parameters relate to both price and volume fluctuations. There is a similar facility for alerting the stock watcher and kicking out parameter violations, as on the NYSE. It is possible also to retrieve and hold almost indefinitely historic information, and there is the capacity for scanning sub-catagories of companies and their relevant market data. Finally, the computers can also retrieve and present, or indeed print out, news releases and comments about particular securities. Thus, if for example, the computers

identified unusual trading patterns in the securities of Exxon, it would be possible for the observer to immediately scan a historic review of trading in that security and also other corporate issuers in the same industrial sub-group, and also retrieve recent news items about that corporation.

Fifthly, the Office of Market Surveillance will be prepared to examine complaints from the public and the industry and, of course, other regulatory agencies. Generally the warnings or complaints come through the Regional Offices, which pass them on to the main office in Washington. Finally, the SEC Regional offices and District Field Offices, as well as the SEC's investigators and examiners might refer cases or suspicions to the Office of Market Surveillance.

As soon as suspicious circumstances are identified, the SEC will have to determine whether there is any ready explanation for the irregularity. This will be primarily a decision for the fifteen analysts employed in the Office of Market Surveillance. The Market Surveillance Office does work in reasonably close cooperation with another Office in the same Division, which is mainly concerned with investigating securities transactions, referred to it by Market Surveillance. This office has a staff of thirteen Attorneys, two Accountants and a resident Analyst. This office will call upon assistance from investigation officers in the SECs Regional and Field Offices, where such is necessary.(570) The Director of the Office of Market Surveillance and the Associate Director of the Division of Enforcement on the available evidence have then to decide whether to recommend to the Commission the making of a formal order of investigation. This has the effect of giving SEC officers subpoena and testimonial powers relevant to that matter. The investigation will invariably be conducted by the relevant Regional Office, often with the assistance of a couple of officers from Washington. Of course, in a number of cases it might be thought that a formal order of investigation is unnecessary.

It is of great interest that the Director of Market Surveillance considers that there is a large number of small transactions probably involving insider trading that were just ignored, or only token efforts made to identify the parties. This was a result of the limited resources available to the SEC. It was admitted that some of the reports sent to the Office by the self-regulatory agencies were filed and never actually examined. It is understood that in cases where only 200 or 300 shares are involved, the SEC would normally only write a 'nasty letter' to the culprit to let him know that the SEC were aware of his transgression, and to warn him against further violations. The Director considers that in the majority of cases this has the desired effect. On the other hand speaking of the probable extent of insider trading, the Director commented

> ' We hardly see the tip of the iceberg .. you could pick up any case and find that someone with access traded. Our problem is that purely and simply we just do not have the staff, and therefore we have to go just for the big transactions although, that is not to say that we would not like to get the small ones as well. The abuse is the same no matter how many dollars you make out of it.' (571)

At the London Conference on Insider Trading in April 1975. the SEC's Chairman, Ray Garrett, said much the same thing.

The most difficult problem in catching insider abuse, in the view of the Director of the Office of Market Surveillance, is the reconstruction of the market which is vital for the identification of the parties. The Office of Market Surveillance or the investigators from the Division of Enforcement will approach the Exchange and obtain copies of the Clearing Sheets. It can take up to a week to get these in some cases. Once these are obtained the brokers names are identified, and enquiries are made as to their clients. This is usually done by sending the broker questionnaires, but if there is a need for urgency, the officers might obtain the information by telephone or by visiting the relevant office. Provided the brokers have properly maintained their records, the SEC could expect to get replies back to their questionnaire

after four days. The main problem from the SEC's standpoint is the presence of nominees, especially foreign nominees, which the Director described as a 'serious and insoluable problem'. One of the greatest problems is knowing when one is dealing with a nominee. It would seem that in many instances the SEC are forced to rely upon past conduct of the parties as an indication of the present. This is naturally most unsatisfactory. Another difficulty is in determining at exactly what time the transaction occurred. However, in most cases it is only necessary to fix the day upon which the transaction occurred.(572)

The Commission seems to be reasonably well satisfied with the present system of market surveillance, and has expressed the view that the strengthening of the SEC's regulatory role should not effect the functioning of the self-regulatory agencies surveillance programmes. Certainly the SEC's Director does not consider that the American taxpayer should be burdened with the tremendous cost that would be involved if the SEC was made responsible for the entire market surveillance programme.

Finally, it should be pointed out that the Commission has the power to suspend trading in a particular security, which can be of major importance with regard to the over-the-counter market.(573) The advantage of an SEC trading halt is that it is effected nationally and prevents circumvention of halts imposed by the self regulatory agencies.(574)

(B) TIMELY DISCLOSURE.

It has already been seen that there are a number of deficiencies in the present disclosure obligations for companies both in the United States of America and in Great Britain. The former SEC Chairman Manuel Cohen put his finger upon the maindeficiency of corporate disclosure in an address to the Securities Analysts Society in Baltimore in January 1969. when he commented

> ' the nature and timing of these reports prevent them from serving as an adequate medium for the rapid and widespread dissemination of current material information to the investing public.'

Thus in recent years growing attention has been given to the question of timely disclosure. The essence of this is the imposition upon the company of a duty to disclose material corporate developments as and when they occur. This is, of course, vitally linked to the problem of insider trading, as an effective system of timely disclosure will effectively take away a substantial number of potential opportunities for insider trading. At the forefront of the development of Timely disclosure in North America have been the national securities exchanges.

One of the longer term results of the SEC's proceedings against the Texas Gulf Sulphur Corporation in the mid 1960s. was the impact that it had on the development of 'Timely Disclosure Policies' by the various self regulatory agencies.

(a) NEW YORK STOCK EXCHANGE

The New York Stock Exchange's (NYSE) policy is laid down in Section A-2, Part 1. of the Listing Agreement (575) and provides

> ' a corporation whose stock is listed on the NYSE is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for securities.'

This is 'one of the most important and fundamental purposes of the listing agreement'. The policy emphasises that the company should act promptly to dispel unfounded rumours which result in unusual activity or price variation. Indeed the company should closely monitor the performance

of its securities in the market immediately prior to a public announcement or when material developments are about to occur or are being contemplated. If there are indications that the information has leaked into the market, then 'a frank and explicit announcement is clearly required.' Of course, the Stock List Division of the Exchange will play an important role in detecting the leakage and in effecting the disclosure, as has already been described. If false rumours are circulating in the market, the corporation should immediately issue an appropriate denial, but where the rumours are correct or substantially correct then, 'an immediate candid statement to the public as to the state of the negotiations or the state of development of the corporate plans in the rumoured area must be made directly and openly.' Moreover, such statements are essential despite the business inconvenience which might be caused , and even though the matter has not yet been presented to the company's Board of Directors for consideration.'

The NYSE is concerned that where unusual trading patterns exist before the announcement of a material corporate development, there will be suspicions of insider trading, and this does nothing for the reputation of the company or the stock exchange. On the other hand, where highly significant developments are being discussed, the Exchange is willing to allow non-disclosure, provided that only 'a small group of the top management of the company ... and their individual confidential advisers' among which adequate security can be maintained, are involved. Where outsiders are involved 'experience has shown that maintaining security ... is virtually impossible. Accordingly, fairness requires that the company make an immediate public announcement as soon as confidential disclosures relating to such important matters are made to outsiders.' Of course in this situation the advice of the NYSE's Listing Representative should be sought. It is not without interest that the Exchange advises that the company should make a point of periodically warning

its Directors and employees over the need to exercise caution when handling such confidential information.

Provided there is honesty and a proper degree of consultation with the Corporate Liaison Department, the NYSE is prepared to allow a corporation to exercise its own discretion as to the timing of public releases. Of course, the Exchange will only allow such a discretion where there has been no leakage of information and where there are no rumours.

In addition there are a number of obligations imposed upon listed companies under the current form of listing, to notify the Exchange immediately upon the occurrence of certain events. Furthermore, under paragraph 13 of the form, the corporation is obliged to furnish the NYSE on demand with such information concerning the company as the Exchange may request.

(b) THE AMERICAN STOCK EXCHANGE

The American Stock Exchange has always placed considerable store by timely disclosure and has long appreciated the deficiencies of 'historical disclosure policies'.(576) But it is only in recent years that it has reduced its timely disclosure policies to a written form.(577)

Here it is underlined that:

> 'the conduct of a fair and orderly market requires every listed company to make available to the public information necessary to informed investing and to ensure that the investors enjoy equal access to information'.

From this the American Stock Exchange has derived six specific policies. Firstly, all material information should be disclosed forthwith. Whether the information is sufficiently material or not, should be determined by reference to whether it is likely to have a substantial or significant impact on the prices of the company's securities, or whether the information after necessary interpretation by analysts is likely to be considered important by investors. This is similar to the advice given by the Vice President of the NYSE 'when in doubt - disclose'.(578) It is interesting that the American Stock Exchange's disclosure policies expressly include market on outside information, within

their purview. Whilst the policy makes it clear that the transactions of insiders and controllers are generally material items of information worthy of disclosure, 'the company should not indiscriminately disclose publicly any knowledge it has of the trading activities of outsiders .. for such outsiders normally have a legitimate interest in preserving confidentiality of their securities transactions'. Of course, this is an area where the advice of the listing representative is very important.

As with the policy of the NYSE it is provided that there are occasions where the company need not disclose material developments. But it is emphasised that these are infrequent exceptions to the general rule requiring disclosure. It is accepted that where immediate disclosure would harm a legitimate corporate purpose, as would the premature disclosure of the mineral strike in the Texas Gulf Sulphur case, disclosure may be postponed. Likewise where the facts are not yet certain and still in a state of flux, disclosure may be postponed for a short space of time. In both instances however, it is mandatory to notify the listing representative so that the stock watch programme can be focused in upon the particular security. Where rumours are present or where there has been a probable leakage of information there must, however, be an immediate release. It is possible even where probable insider trading is present, provided it is not significant and steps have been taken to prevent its continuation and re-occurrence, to hold disclosure temporarily with the consent of the listing representative and in conjunction with the Market Surveillance Department. The NYSE consider, however, that as soon as a leakage is discovered there must be complete disclosure no matter how significant the abusive trading is to the market. The Chief Regional Administrator of the SEC's Regional Office in New York thought that as a practical matter such a strict approach was not really warranted in all cases, but admitted that the legal position was unclear, and probably as a matter of law under Rule 10(b)(5) as soon as an informational inbalance had been detected disclosure should follow.

The American Stock Exchange, as does the NYSE, emphasises the importance of preserving confidentiality in the corporation, and advises that those insiders, and where necessary, outsiders are in possession of material undisclosed information, they should be obliged to report their transactions to the company, or where they are outsiders to their superiors.

The second policy is that where a company is obliged to make a public disclosure, it should do so in a manner designed to obtain the fullest possible dissemination. To this end the Exchange favours disclosure after the trading markets have closed.

The third policy requires the company to clarify or confirm rumours wherever such are present, and the same considerations apply as those already mentioned in connection with the NYSE.

The fourth policy relates to unusual market activity, which the American Stock Exchange points out is often, although not invariably, the result of insider trading. Even where it is not, it is probable that such will mislead investors 'who are likely to assume that a sudden and appreciable change in the price of the company's stock must reflect a parallel change in its business or prospects. Similarly, unusual trading volume, even when not accompanied by significant change in price, tends to encourage rumours and give rise to excessive speculative trading activity which may be unrelated to actual developments in the company's affairs.' Where the issuer discovers or is alerted to such abnormal trading conditions, the issuer should immediately seek to ascertain the reasons, and should in particular consider whether there is any information about itself which would possibly account for the abnormal trading, which has recently been disclosed, or which has not yet been released. If the company decides that the abnormal trading is due to information that has already been disclosed then, unless it is misinterpreted, no further announcement is necessary. Where it appears that there has been a leakage of confidential information, it is necessary to make a public disclosure of the information immediately. Where the corporation cannot ascertain a reason for the abnormal trading, it should make

a statement to this effect and emphasise that there have been no material corporate developments.

The fifth policy is concerned with promotional disclosures which are made for the purpose of influencing share prices rather than informing investors. The American Stock Exchange considers that these are both unnecessary and unwarranted.

Finally, the sixth policy is directed specifically at insider trading and will be examined in due course.

The American Stock Exchanges policies were reduced to written form after those of the NYSE and thus have the benefit of greater experience. In this respect it is interesting that the American Stock Exchanges disclosure policy deals at some length with the content and preparation of public announcements, something that is given only passing reference in the NYSE's Expanded Disclosure Policy.

Virtually all other national securities exchanges operate Timely Disclosure Policies, although probably not of the same standard as those of the NYSE and American Stock Exchanges, with the possible exceptions of that of the Midwest Stock Exchange. (579)

(c) N.A.S.D. and N.A.S.D.A.Q.

As has already been mentioned the NASD and NASDAQ do not have anything approaching a listing agreement with the issuers whose securities are traded upon the Over-the-counter market. On the other hand the NASD will not allow quotations to be carried on its services unless the company's policy is 'to disclose promptly to the public through the press, information with respect to significant corporate developments which may influence investors decisions.' (580) Furthermore, the rules adopted by the Board of Governors for the operation of NASDAQ provide that a security is ineligible for quotation if there shall have been a failure by the issuer to promptly disclose to the public through the press any material information which may affect the value of the securities or influence investors decisions.' (581)

(d) EFFECTIVENESS OF SELF REGULATORY TIMELY DISCLOSURE POLICIES.

The administration of timely disclosure is probably far better left to the self-regulatory bodies who have a much greater proximity to the market itself, and are more able to evaluate the different, often conflicting considerations. (582)

The sanctions possessed by the securities exchanges in particular are significant. The threat of a suspension or de-listing is invariably all that is required to achieve the desired result. It is rarely the case that exchange will be forced to actually delist.[583] It is important that the responsibility for administering timely disclosure should be on the same regulator primarily responsible for market surveillance as the two things are very much related. Thus it would seem that the efforts of the national securities exchanges and the NASD in the area of timely disclosure in the United States have had a salutary effect on the order and fairness of the securities markets, and achieved a reasonable degree of success and effectiveness.

(C) THE S.E.C. AND TIMELY DISCLOSURE

(a) TIMELY DISCLOSURE - A LEGAL REQUIREMENT

In recent years the SEC has been conscious of the fact that the market is damnified as a whole just as much where there has been a material non-disclosure of a significant corporate development as when insiders are trading on the basis of such. (584) The SEC has acted cautiously however, and has been reluctant to impose a similar duty of timely disclosure under Rule 10(b)(5) to that developed by the self-regulatory authorities. For example, in the SEC's action against the Texas Gulf Sulphur Corporation, it did not allege that there was a duty of timely disclosure on the issuer as such, but that in the circumstances the failure to correct a statement that it had already published, constituted a mis-statement. The Courts and the SEC seemed to consider the period of complete non-disclosure whilst the company was attempting to acquire the other claims unobjectionable. The Court of Appeals expressly stated:

> 'we do not suggest that material facts must be disclosed immediately the timing of disclosure is a matter for the business judgement of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and the SEC. (585)

This would seem to place the timing of disclosure with regard to material corporate developments fairly within the honest discretion of the management. However, District Judge Bonsal in the forty consolidated private actions brought against Texas Gulf Sulphur Corporation,(586) that this was in fact the case. He considered that the information was 'ripe for disclosure' at an earlier date, and intimated that all those investors who traded in between this time and the date of effective disclosure might have a ground for civil recovery. (587) Where the failure to disclose can be said to be part of a manipulative design, then there is no question that liability can be predicted.(588) But cogent evidence must be shown to displace the business judgment rule, and the mere showing of a strong 'motive not to disclose' is not enough.(589) Even where the duty to disclose can be said to arise, the information must be 'ripe' for disclosure.

This means that there must be 'time to verify the data and assure its accuracy'.(590) Where a company makes selective disclosures to analysts and brokers it would seem that it would be hard put to argue that the information was not ripe for general disclosure,(591) and is being withheld for a valid business reason.

The position remains unclear however where there is complete non-disclosure and no prior statement or manipulative design.(592) It would be a radical extension of the law of disclosure to hold that all companies have an obligation under Rule 10(b)(5) to publicly release all material items of information relevant to the market in their securities as soon as they have had an opportunity for checking its accuracy, and there is no business reason supporting non-disclosure. Of course, where the company is itself trading, or where it has already leaked the information, the matter is completely different. The present uncertainty is compounded by the proposed Draft Federal Securities Code which seeks to impose no affirmative duty on the corporate issuer or indeed any other person who is not trading to disclose material information. The Comment to Section 1304 at paragraph (3) emphatically states that there is no duty to disclose now in such cases, and that 'apart from the new rule making authority in Section 601(a) it will not be unlawful under the Code. The remedy in that event is and will be a summary suspension of trading in appropriate cases'. The present author has much sympathy with this view and would consider that it has the support of the securities exchanges, the Commission staff and the corporate community generally.

Although the SEC has emphasised the importance of timely disclosure,(593) there has been no real attempt on the part of the SEC to impose anything approaching an affirmative duty of timely disclosure. The Wheat Report, at page 39 commented that:

> 'the Commission current reporting requirements necessarily play a somewhat different role. They are not intended to, nor could they adequately duplicate the timely disclosure policies of the self-regulatory agencies. SEC requirements act to a degree as a backstop for those policies they operate to encourage willingness on the part of the issuer to keep the market place informed.

> They provide details that may be overlooked in the preparation of the news release or may not be included in a published news report.'

It would appear from the observations of Assistant General Counsel Feurestein (594) that provided the self regulatory agencies properly administer their timely disclosure policies, the Commission is not anxious to interfere.

If the SEC did promulgate a rule requiring timely disclosure this would, of course, give the present regulation another dimension, that of law, with the possibility of legal enforcement,enforcement including probably civil liability. Indeed under a recently developing body of law it is even possible that there may be an implied civil action for violations of the self-regulatory timely disclosure policies against those responsible for the violation. (595) There has been a growing concern in the United States as to whether this additional dimension is necessary. The SEC's Staff Report on the Financial collapse of the Penn Central Company discovered substantial non-compliance with timely disclosure requirements and rampant insider trading. (596) Indeed the Commission in its letter of transmittal of the Report to the Congress commented

> 'the cornerstone of public confidence in our securities laws is full, accurate and meaningful disclosure made on a timely basis to all investors. The Commission's Staff Report shows a wide margin of failure on the part of the Penn Central company in meeting this standard.' (597)

There is a considerable degree of criticism however, about the lack of action by the SEC. Indeed, the Staff Report of the House Banking Committee on the Penn Central Failure and the Role of the Financial Institutions was concerned that

> ' at a minimum it seems essential that the people be made aware of what the SEC will do, and can do with its powers to protect the public in such situations, even though it does not always do so.'

In recent years a number of SEC Chairmen have advocated the SECbecoming more, involved with this problem. (598) Even the majority of the Court of Appeals for the Second Circuit in

the Texas Gulf Sulphur case considered that the SEC has power under Rule 10(b)(5) to promulgate a rule specifically upon timely disclosure.(599)

Although the self-regulatory agencies consider that a corporation should issue a release where the market is effected by rumour, even though such eminates from a source other than the company, the law has not yet gone this far.(600) Where the corporation has made a statement previously which is in some way connected to the rumour, there can be liability for a failure to adequately correct the market.(601)

To alleviate these uncertainties the SEC has considered drawing up guidelines on material non-public information, and to this end solicited comments from interested parties.(602) The Sec was particularly concerned with the point at which it could be said information had been sufficiently disseminated to take away its privileged status, and whether there should be mandatory time limits after the publication of such information during which insiders could not trade, so as to allow public dissemination. Although the SEC finally decided that the drawing up of such rules would inhibit flexibility and were thus rejected, the submissions of the American Bar Association to the General Counsel of the SEC are worth a brief mention.(603) The ABA doubted whether the present system of timely disclosure was as effective as it might appear. They were particularly concerned that smaller issuers did not get adequate coverage by the media, and that there were informational inbalances resulting from geographical proximity. The ABA recommended that

> 'previously undisclosed material information concerning an issuer will be deemed to have publicly disseminated when such information has been released for transmittal to the financial community comprising the principal trading market for the securities of the issuer through such means of communication as may assure, in the light of the extent of the market significance of the issuers securities and of such information, that such information will thereby become public knowledge in the relevant financial community.'

The ABA does not consider that the fact that the issuers obligations are fulfilled by disclosure in this way, should mean that its insiders are at liberty to trade upon the impact of such by virtue of their prior knowledge. The present author respectfully submits that the distinction of these two questions is to be welcomed and should be more widely appreciated. The ABA thus recommends that the SEC establish guidelines laying down waiting periods during which the issuer and insiders with prior knowledge of the information must abstain from the market after public dissemination has taken place, so that the market has time to properly digest the information and thus eliminate the entirity of the insiders privileged position. If insiders wait and observe these periods, the ABA consider that their transactions should be presumptively lawful. The ABA consider that tippees should be under the same disability.

> 'Insiders may lawfully trade in the securities of an issuer as to which material information has been publicly disseminated within the meaning already discussed, after the earlier of (i) the end of the first complete calendar day during which any major stock exchange is open for trading in the security, or the NASDAQ system is in operation, following receipt of such information by the relevant financial community or communities, or (ii) the end of the seventh complete calendar day following release of such information for transmittal to the relevant financial community or communities.'

These guidelines could be 'safe harbour' tests or alternatively prohibitions, or indeed presumptions against trading rebuttable by evidence of earlier full public dissemination.

The basic objective of these recommendations is to allow for a period of digestion, the absence of which the ABA thought to be one of the greatest deficiencies with the present practice. Of course, the waiting periods must needs be arbitrary, although an attempt has been made to distinguish between the disclosure capabilities of the larger corporations and those of the smaller company, where in many cases the company would have to resort to mailing. It is not without

significance that the Court of Appeals in the Texas Gulf Sulphur case observed that

> ' in any event the permissable timing of insiders transactions after disclosures of various sorts is one of the many areas of expertise for appropriate exercise by the Commission's rule-making powers, which we hope will be utilised in the future to provide some predictability and certainty for the business community.' (604)

The decision of the SEC not to exercise its 'expertise' in this 'fuzzy' area of the law (605) has met with considerable opposition. Fortunately the self-regulatory agencies have not been so hesitant and have sought to facilitate an acceptable degree of certainty by publishing guidelines for insiders with regard to their trading activities and the relationship of such to timely disclosure. The NYSE sends free to all corporate directors of listed corporations a fifty page booklet entitled 'the Corporate Director and the Investing Public.' (606)

The NYSE places considerable importance on strict internal supervision and the drawing up and administration of inhouse procedures to combat insider trading. The Exchange advocates shareownership by managers in their corporations, but warns that 'hindsight' is remarkably keen and the acquisition can always be made that a purchase and sale of stock by a director was motivated by inside knowledge ..' The NYSE to assist corporate insiders has drawn up a series of policies which, if followed, should in many cases rebut the presumption of insider trading abuse. Firstly, investment according to a predetermined periodic investment plan is advocated, provided that it is administered by a thoroughly independant and unconnected broker. Secondly, a prudent insider would be advised to deal within a thirty day period, commencing one week from the mailing to the shareholders of the annual report provided, of course, there have not been subsequent undisclosed material corporate developments. Thirdly, insiders should be able to deal, after the publication of quarterly reports, and the publication of such disclosure documents, such as prospectuses and proxy statements,

provided there have been no other developments and a reasonable period for dissemination is allowed. Fourthly, insiders should never deal before the publication of such disclosure documents or releases relating to earnings, dividends or indeed any other material information, and where there has been a material disclosure, insiders should refrain from dealing for at least twenty four hours.

The NYSE makes it clear that similar considerations apply to the granting and taking up of stock options, and to trading in the securities of other corporations, such as target corporations or subsidiaries and holding companies. Furthermore, the same obligations apply equally to members of the insider's family and his close associates. The Exchange justifies this offer 'unjustified' extension of liability on the basis of public opinion and suspicion, which it feels necessary to placate.

The American Stock Exchange, in its sixth policy of its 'Disclosure Policies' states that insiders should never trade prior to the public disclosure of material information and 'even after material information has been released to the press and other media 'should not trade' for a period sufficient to permit through public dissemination and evaluation of the information'. The policy then goes on to define both insider and inside information in expansive terms, something that the NYSE does not attempt. Substantively, however, the two policies are very similar. It is interesting that the Manager of the NASDAQ Market Surveillance Department considers that although the NASD does not publish policies similar to the major exchanges, the NASD would support and subscribe to those of the American Stock Exchange.(607) It is also of interest that a number of other organisations have attempted to issue guidelines in an area where the SEC has remained largely aloof.(608)

(b) THE PROBLEM OF DISSEMINATION

The self-regulatory agencies attach considerable importance to there being a period of time during which insiders with advanced knowledge of the subject matter of the disclosure should not trade immediately after the making of the disclosure, so that there is a chance for dissemination. Indeed the American Bar Association thought that the absence of such a

legal requirement was one of the most serious deficiencies of the present system. Of course, in essence this argument is based more on the attainment of practical informational equality than the mere prevention of insider advantage, as it recognises the advantages possessed by those in close proximity to the disclosure and the markets.

The question arose in the Texas Gulf Sulphur case as to whether Rule 10(b)(5) required such a period for dissemination during which time trading insiders could be held liable. It is illustrative to mention the facts in some detail, with regard to two of the defendants. Coates was a lawyer and a director of the issuer. He maintained that he had not heard of the discovery until April 13th 1964, when he read the first corporate press release in the newspapers. He claimed this comprised the entirety of his knowledge until he read late on the 15th April, a draft press release at the company's head office, which was published the following day. Coates was told that the Canadian Minister of Mines was going to make a public statement on the strike at Timmins that very night, and the following morning was erroneously informed that such a statement had in fact been made.(609) There was a Board meeting on the 16th April, where the Board approved the draft and issued a statement revealing the true magnitude of the strike to a press conference. Coates was at the Board Meeting and saw that the Dow-Jones correspondent left immediately on publication of the release to contact his office. Normally, a communication from a correspondent of such magnitude would be on the tape within a couple of minutes.(610) However, because of the number of delays caused by extraneous reasons, the tape did not carry the announcement for some forty five minutes.

After the conclusion of the press conference Coates telephoned H.Fred Haemisegger, his son-in-law, who was a broker in Rauscher, Pierce & Co., and instructed him to purchase 2,000 Texas Gulf Sulphur securities for the Coates family trust. Although Coates told Haemisegger that there had jist been 'a big release' from the corporation, he did not tell him the details or recommend that Haemisegger dealt himself. Haemisegger immediately acquired a substantial amount of

Texas Gulf Sulphur securities for himself and for four favoured clients.[611] At the time of the telephone conversation Coates thought that Dow-Jones would have already carried the release. Indeed the internal news wire service of Merrill Lynch carried the release a full twenty five minutes before Dow-Jones.[612] Thus Coates claimed that

> ' he had every reason to assume that the news of the Timmins discovery was no longer inside information.' (613)

District Judge Bonsal found however, that 'Coates lost no time in telephoning his son-in-law ... and that he could not assume ... without thinking about it that the discovery was already a matter of public information.' (614) Nonetheless Judge Bonsal held that the disclosure had been made 'and it has generally been accepted that it is the making of the announcement that controls.' Referring to the SEC's contention that there should be a 'digestion period', the Court expressed some sympathy and even proffered the view that those in the communication media, and thus in a privileged position with regard to the receipt of such information, should perhaps have to wait.[615] Judge Bonsal disagreed with the proposition that the Courts should create such a rule, and it would be more appropriate if the SEC exercised its rule-making powers.[616]

The other defendant relevant to this discussion was a Mr. Lamont, who was a director of Texas Gulf Sulphur, and also of Morgan Guaranty Trust Company. He claimed that he first heard of the discovery on the 10th April., but only in outline, and that he did not know of the details until he read the full announcement of the Board in the press following the press conference on the 16th April.[617] Evidently after the news had been released to the Press Conference, Lamont telephoned the Executive Vice President of Morgan Guaranty Trust and advised him that good news about Texas Gulf Sulphur Corporation would be coming over the tape shortly. The Executive Vice President immediately relayed this 'tip' to the banks Trust Department, which immediately purchased 10,000 shares. The telephone call

by Lamont was made twenty minutes after Coates made his, but before the release was carried by the Dow-Jones. Two hours after the announcement Lamont acquired securities in the company for his own account. District Judge Bonsal rejected the charges against Lamont for the same reasons as those relating to Coates. (618)

On appeal to the Court of Appeals for the Second Circuit the SEC contended that Judge Bonsal's decision was erroneous. In the case of Coates it was argued that even if the Canadian Minister had made a statement which, in fact he had not, that could not be the equivalent of a release from the company. (619) The SEC also argued that even if the release had been carried by Dow-Jones without any delay, the telephone call to Haemiseggar was still two minutes premature. With regard to Lamont, the SEC argued that it simply was not enought for him to argue that he did not know whether the information had been carried on the tapes or not. Although Coates' counsel accepted that a rule requiring a period of non-trading for dissemination and evaluation might be desirable, this was a matter for the Commission and that it would be anomalous if Coates was to be regarded as 'fraudulent', and yet brokers and reporters attending the Press Conference could have 'called the market before their office.' (620)

The defendant Lamont unfortunately died before the the hearing of the appeal, and pursuant to stipulation the judgement relating to his case was severed from the appeal. (621) The Second Circuit with regard to Coates reversed the District Courts decision and found liability. Circuit Judge Waterman stated that

> 'before insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to ensure its availability to the investing public.' (622)

The majority were of the opinion that Judge Bonsal had misinterpreted the purport of the Commission's decision in Cady Roberts (623) and that merely issuing the information only (624)

> 'the first step in the process of dissemination required for compliance with the

> Regulatory objective of providing all investors with an equal opportunity to make informed investment judgements.'

Circuit Judge Waterman continued that,

> 'assuming the contents of the official release could instantaneously be acted upon, at the minimum Coates should have waited until the news could reasonably have been expected to appear over the media of widest circulation, the Dow-Jones Broad Tape, rather than hastening to ensure an advantage to himself and his broker son-in-law.' (625)

The SEC's Main Brief had contended that the effective point of disclosure should be the informations 'appearance in the morning papers.' (626) Indeed the Commission argued that until an opportunity has been 'accorded to stock holders considering a sale of their holdings to consult their advisers as to the significance of the news' it remains inside information from the standpoint of insiders. (627) Of course in the present case, the fact that the only defendant to trade between the appearance of the news on the tapes and in the news papers died, removed the need for the Court to consider how long insiders must hold back. (628)

A former Executive Assistant to the Commission has advised insiders as a matter of policy to forego trading for a period of twenty-four hours. (629) On the other hand the SEC has consistently argued against promulgation of a rule fixing and defining an arbitrary period, as the very vagueness of the requirement acts as a deterrent. (630) In Shapiro v. Merrill Lynch, Pierce, Fenner & Smith Inc. (631) District Judge Tenny emphasised that persons trading once the information had been released and disseminated, could not be allowed to 'but it could not be said ... that full disclosure had been achieved within two minutes of its release.' (632) Insiders are placed at a considerable disadvantage, in a highly uncertain area. The mere fact that the market price has moved after the disclosure, will not necessarily mean that there has been a sufficient dissemination. (633)

Furthermore, as the Counsel for Coates pointed out in the Texas Gulf Sulphur case, to require corporate insiders to wait during disclosure, dissemination and probably evaluation, is to place such behind all those who receive the information during this period, and who can act upon it immediately. Professor Jennings has argued that this will have the salutory effect of encouraging strict internal corporate security and uniform disclosures outside market business hours. (634) Moreover, as the SEC contended in their Main Brief in the Texas Gulf Sulphur case, any different rule would encourage insiders to publish the information in the least efficient manner. (635)