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Articles

The Control of Insider Trading—Smoke and Mirrors!

Barry A. K. Rider*

I. Insider Dealing—Is Anyone Bothered?

There was a time in Britain when even senior representatives of the financial services industry were prepared to be quoted in the press, as expressing doubts as to whether there was anything intrinsically wrong with directors and other corporate insiders taking advantage of their better knowledge about their companies, in their own investment dealings. Indeed, some even went so far as to say that this was both proper and natural. True it is that, in Britain or for that much in continental Europe, there are few, even among the groves of academia, that would have advanced the theories justifying insider dealing that Professor Henry Manne so clearly articulated in *Insider Trading and the Stock Market*.¹ Nonetheless, in what was then the leading book on the law and practise of the stock market, the authors, a leading Queens Counsel and an eminent stockbroker, expressed the view in 1972 that a

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1. *INSIDER TRADING AND THE STOCK MARKET* (The Free Press 1966).

stockbroker who learnt even privileged information should not allow this to operate to the detriment of his client.² Having said this Sir Winston Churchill complained that it was defamatory to assert that advantage had been taken of “inside information” during the so called Marconi scandal in 1911³ and there are comments in a report to the House of Commons by special commissioners as early as November 1696⁴ roundly criticising promoters of overvalued stock selling out, in the entrepreneurial fashion eloquently advocated by Professor Manne, on the basis of their privileged knowledge and position. Thus, discussion of the pros and cons of insider dealing, at least in Britain, has tended to be emotional rather than based on economic or even pseudo-economic analysis of empirical data. Even the surveys that have been conducted on attitudes to the practice would hardly impress a statistician.

In fact, little attempt has been made in Britain to examine the incidence of insider abuse, save than on an anecdotal basis, other than in the context of take-over activity. Even here, the results do little more than indicate, the market tends to creep up before a bid is announced, a hardly surprising conclusion whether we take the market as efficient, in any of the classic formulations, or merely prone to influence by those in the know. Sadly, like in so many other areas of activity even the statistical information that we have been able to develop and collate in a reasonably intelligent fashion, serves almost any argument that can be advanced with plausibility. Perhaps one of the less conspiratorial reasons why so little real research has taken place in Britain is because we have so few academics interested in the regulation of financial markets.⁵ Indeed, there are probably fewer legal scholars interested in the topic today in Britain than there was before we had any substantive law.⁶ In fact, the University of Cambridge took the subject out of its syllabus three years ago, after teaching it for seventeen years! In the result academic lawyers in Britain have not been tempted into

2. COOPER & CRIDLAN, *THE LAW AND PROCEDURE OF THE STOCK EXCHANGE* 104 (Sweet & Maxwell 1972).

3. See BARRY RIDER & H. LEIGH FRENCH, *THE REGULATION OF INSIDER TRADING* 1 (1979). *THE COMMERCIAL AND FINANCIAL CHRONICLE*, Feb. 8, 1872 referred to insider dealing as being “a very great evil.”

4. H.C. JOUR., Nov. 25, 1696.

5. See Barry Rider, *Centering Company Law*, 17 *CO. LAW* (1996) at 289, Barry Rider, *A Missed Opportunity*, 6 *JFC* 103 (1998), and Barry Rider (Ed.), *The Corporate Dimension*, (Jordans 1998).

6. See Barry Rider (ed.), *Casting the Runes*, *LAW AT THE CENTRE*, (Kluwer 1999); see also BARRY RIDER (Ed.), *THE REALM OF COMPANY LAW* (Kluwer 1998).

the areas of analysis that their North American counterparts have. Indeed, the appreciation of many scholars in many of our law schools of such work is problematical. Socioeconomic analysis of issues in the context of the law is not nearly established in Britain as it is in some other countries and therefore has not been able to make the contribution that it should to the debate on such matters as insider dealing. The research and deliberation that has taken place has tended to follow well tested if not now well worn paths of jurisprudence. The most recent writings do little more than reiterate the discussions that took place, invariably outside academia, in the early to mid 1970s.⁷

II. Fiduciaries and Insiders

The common law given its pragmatic determination to avoid the conceptual ticket that it might otherwise have had to cut its way through, had it ever deigned to recognise that unfairness is a meaningful issue in the determination as to the existence of a right rather than merely its exercise, has little to offer in regard to insider trading.⁸ The principle of “caveat emptor” reinforced by the pervading notion that mere reticence cannot amount to fraud, has rendered those disadvantaged in dealing with an insider in practical terms remediless. It is only where the plaintiff can establish a relationship which justifies the invocation of equitable principles of fair dealing, or the circumstances⁹ import an extraneous duty of disclosure that a failure to share the privileged information in question will be actionable at English law. Of course, where the parties are not in a direct and probably personal transaction the chances of constructing a special relationship importing such obligations of disclosure or at least fair dealing, become remote if not negligible. Even if it is possible to find a operative misrepresentation, which invariably it is not, in the context of an indirect and impersonal transaction—such as that on a market, the problems of either determining a satisfactory remedy let alone establishing causal loss are such as to defeat other than the most

7. See, e.g., B. BERGMANS, *INSIDE INFORMATION AND SECURITIES TRADING* (Graham & Trotman 1991).

8. See BARRY RIDER AND T.M. ASHE (Eds.), *THE FIDUCIARY, THE INSIDER AND THE CONFLICT* Ch. 12 (Brehon, Sweet & Maxwell 1995); Barry Rider, *Conflict of Interest: An English Problem, in EUROPEAN SECURITIES MARKETS* (Kluwer 1998); and BARRY RIDER, *INSIDER TRADING*, Ch. 2 (Jordans 1983).

9. See Barry Rider, 40 M.L.R. 471 (1977); 41 M.L.R. 583 (1978); and Barry Rider, *Partnership Law and its Impact on Domestic Companies*, 38 CAMBRIDGE L.J. 148 (1979).

imaginative academic. The English courts always conscious not to open the “floodgates” to litigation, have always shown a marked reluctance to contemplate implied representations of any kind, let alone as to fair dealing, in commercial and market transactions. The common law does not sit comfortably with civilian notions of good faith. This is so even in the restrictive and determined context of a contract, let alone in the wider and ill-defined environment of a market with essentially random coupling or parties, where privity is at best a fiction. The only indication that the common law’s indifference might be a little more equivocal than the vast bulk of precedent would fairly indicate, is the possibility that a court might refrain from lending to a party its support in enforcing a bargain which would amount to the crime of insider dealing.¹⁰ The argument that as a matter of public policy such contracts should be unenforceable is far more problematical.

Notwithstanding the coyness of the common law to do more than protect the kind of rights that our Anglo Saxon forebears would have recognised, some have pointed to the cases on what for want of a better term might be described as “secret profits.” Where a fiduciary takes advantage, without full disclosure and assent, of information and or an opportunity that comes to him by virtue of his position as a fiduciary, then the cases indicate that he may well be called to account to his principal for any benefit he makes. This liability to yield up the “secret profit” is personal to the fiduciary and would apparently not extend to the situation where he allows another to so benefit. Furthermore, it is not at all certain that this sort of liability extends to the making of a “secret profit” by avoiding an otherwise certain loss. The important point to remember is that the claim for an account, is not a compensatory remedy, it is a process developed in Chancery to vindicate and reinforce notions of good stewardship. While it now seems likely that it may be possible to trace the proceeds of an actual profit, notwithstanding the absence of a traditional “proprietary relationship”¹¹ and the courts have recently recognised a restitutionary measure of damages in contract,¹² in practice the contention that this area of the law is a satisfactory control in insider abuse is nonsense. While there have been cases where fiduciaries and former fiduciaries have been held to account for the

10. See *Chase Manhattan Equities Ltd. v. Goodman*, B.C.L.C. 897 (1991), discussed in BARRY RIDER & T.M. ASHE, *INSIDER CRIME* 65 (Jordans 1993).

11. *Attorney General of Hong Kong v. Reid*, 1 All E.R. 1 (1994).

12. *Attorney General v. Blake*, 1 All E.R. 833 (1998).

profits that they have made by effectively using privileged information and opportunity,¹³ there are no cases in England and precious few in the Commonwealth,¹⁴ that give any credibility to the view that the fiduciary obligation is a real constraint on insider dealing. The essential limitations of the action and the practical difficulties of proof and standing before the courts, not to mention costs, combine to render this weapon of little use. Even if by legal magic we convert the inside information in question into some form of property, as it has been argued was done in at least one major decision of the House of Lords,¹⁵ and then attempt to invoke the law of constructive trust, which itself has in recent years become vibrant, it is not clear that in practical terms we have a better or more efficacious weapon.

Thus, even in the very realm of law which does concern itself about fair dealing and good faith; namely equity; in practical terms the issues that we encounter in insider dealing cases have not been addressed. Indeed, the very jurisdiction of the courts to enforce good stewardship is not entirely clear. It is contended, that the obligation not to take an unauthorised benefit stems from that fundamental and immutable obligation on all fiduciaries to eschew conflicts of interest and duty. By succumbing to the temptation to derive a benefit, which he is not prepared to disclose and submit to his principal, the fiduciary has placed himself in a position where his own self interest is in open competition with his paramount duty to that principal.¹⁶ It is not, however, always the case that such a trite and simple analysis can be justified. Even if the rule is regarded as being of such fundamental importance to the honour of equity that no departure from the strict ethic can be tolerated, even where there is no loss to the principal and no real issue as to competition, the courts have found difficulty in applying it in cases of conflict where more than two parties are involved.¹⁷ It is perhaps better to regard the fiduciary as being under a disability rather than under an affirmative obligation to favour, at all costs, the advantage of one

13. See *Regal (Hastings) Ltd. v. Gulliver*, 2 A.C. 134 (1967); *Boardman v. Phipps*, 2 A.C. 46 (1967) (but note the fact that those who were held liable to account had acted without probity). See Barry Rider, *Amiable Lunatics and the Rule in Foss v. Harbottle*, C.L.J. 270, 276 (1978).

14. See *Glandon Pty. Ltd. v. Strata Consolidated Pty. Ltd.*, 11 A.C.S.R. 543 (1993).

15. See *Attorney General of Hong Kong v. Reid*, *supra* note 11; see generally GORE-BROWNE ON COMPANIES Ch. 12 (Jordans).

16. See generally C. NAKAJIMA, *CONFLICTS OF INTEREST AND DUTY* (Kluwer 1999).

17. Barry Rider, *The Fiduciary and the Frying Pan*, *CONVEYANCER* 114 (1978).

principal against another, or even conceivably himself. While of considerable importance, these matters are fairly beyond the scope of our present discussion, but it is pertinent to note that even in such a well rehearsed area of the law, the issues are still in debate.

III. The Legislators and Insider Trading

If the courts have not articulated any principle that can be invoked in rationalising the control of insider abuse, it must be said that in Britain, Parliament has done little more. Although there were those who argued that the use or may we say, disclosing our own predilections, the abuse of inside information needed to be circumscribed by legislative action, such views were not well conceived, with the exception of the Jenkins Committee,¹⁸ until the early Seventies. Legislative action against insider abuse before this was confined to requiring directors to report their own and families' dealings in the securities of their own and associated issuers¹⁹ and to a blanket prohibition on the purchase of options,²⁰ of any kind, in the securities of their own company or an associated issuer, on their own behalf or that of their immediate family. As it was by no means certain that taking advantage of inside information was considered improper, until relatively recently, by those likely to be aware a director had reported his dealings, it is far from clear that the disclosure of insider transactions had any real effect in discouraging the abuse of inside information. Of course, even today when such disclosure obligations, reinforced by the requirements of The Stock Exchange and other markets, are so easily evaded or ignored it remains to be seen whether they serve to discourage, rather than merely inconvenience, the determined insider dealer. The policing of the statutory obligations by the authorities is virtually non-existent and those that have been prosecuted for failure to obey them can be counted on one's fingers. The prohibition on buying options, which one would have thought would be highly relevant to the control of insider abuse in the derivatives market, has been invoked on three occasions since 1967.

Whether the then, essentially self-regulatory, system did fail—to the degree that it has been assumed, in controlling insider trading, is not as certain as some claim.²¹ The self-regulators were

18. Cmd. 1749 (1962).

19. Companies Act, §§ 324 to 329 (1985).

20. *Id.* at § 323.

21. See generally Barry Rider and E. Hew, *The Regulation of Corporation and*

reasonably efficient in smelling out misconduct and in “punishing” those responsible. Of course, the processes were not as transparent and as independent as we have come to expect of those charged with such a function and the punishments were often ill-defined and smacked more of exclusion than a formal sanction. However, when the City was reasonably homogeneous and confined within the village of the “Square Mile” it did achieve a level of efficacy which would surprise many. The suspension of exchange control regulation which served as a catalyst for the fundamental changes that occurred in the structure of the financial intermediaries and the way in which business is conducted, effectively undermined the ability of the various self-regulatory and essentially self-interested authorities to police an international market. It also became increasingly apparent that the gentlemanly procedures of the City bodies were no match for those who deliberately set about manipulating and despoiling the markets. Self-regulators without the power to conduct investigations otherwise than on the basis of consent could not deal with foreign nominees and individuals who did not care whether they were respected in the City and West End clubs. Consequently, there were increasingly calls for statutory intervention in regard to what the then Conservative Prime Minister, The Rt. Hon. Edward Heath MP described as the most unpleasant wart on the ugly face of capitalism, insider dealing.²² The press focused on cases of insider abuse that surfaced, mainly in the context of contested international take-overs,²³ invariably there was rather more involved than the taking advantage of privileged information, but it was the “capitalist crime par excellence” which attracted most of the comment. The milking of inside information by those on the inside track accentuated all the other, actual and perceived, inequalities of the City and its new operators. Insider dealing is unfair, because those who can take advantage of inside information are placed in such a privileged position unfairly. They went to the right schools, they were always on the inside—it was portrayed, with some justification in the popular press, as a “them

Securities Laws in Britain—The Beginning of the Real Debate, 19 MAL. L.R. 144 (1977); Barry Rider and E. Hew, *The Structure of Regulation and Supervision in the Field of Corporation and Securities Laws in Britain*, 41 REVUE DE LA BANQUE 83 (1977); and Barry Rider, *Policing the City—Combating Fraud and other Abuses in the Corporate Securities Industry*, 41 CURRENT LEGAL PROBLEMS 47 (1988).

22. See Barry Rider, *One Aspect of the Unacceptable Face of Capitalism: The Crime of Being Something Big in the City*, OBITER 9 (1975).

23. See generally Barry Rider and E. Hew, *The Role of the City Panel on Take-overs and Mergers in the Regulation of Insider Trading in Britain*, 20 MAL. L.R. 315 (1978).

and us” issue. Much in the same way as in recent years in Britain, popular attention has focused on what are considered to be excessive executive benefits and remuneration for “fat cat” directors and corporate employees.²⁴

The City bodies fearful that a full blown regulator with legal powers would be imposed on the industry, were happy to deflect attention on to the need for tough legislation to criminalise insider abuse. This had the effect, when it occurred in 1980, of placing the policing of this thorny problem beyond their remit. The Panel on Take-overs and Mergers, which had always achieved a level of success in policing the anti-insider dealing provisions in its Code,²⁵ was pleased to announce that now that insider dealing was a specific crime, it would be highly inappropriate for it, as a self-regulatory authority, to attempt to investigate cases which might end up before the courts. Outlawing insider abuse effectively removed responsibility for policing it from the City to the government and the police. Of course, the self-regulators were prepared to cooperate with the authorities, provided their constitutions and members enabled and permitted them to do so, and in the few instances that the Department of Trade and Industry and the police were able to identify abuse, take some action within their own disciplinary jurisdiction.

Those who called for statutory intervention, did so on the basis that insider trading was an abuse against the market and therefore a wrong deserving of public sanction through the criminal law. This was logical if not particularly imaginative. The criminal law has long been used in Britain in protecting markets²⁶ on the basis that the State has a real responsibility to ensure that such function efficiently and properly. Furthermore, history records that the Crown and other public authorities had a financial interest in the holding of markets and were therefore concerned that nothing was done to undermine their viability. It is also the case, that there is a strongly rooted view within British society that where a public sanction is to be applied, then it is proper that the accused should have the protections guaranteed by the traditional criminal justice

24. L. Miles, *Fat Cats and Windfall Tax*, 19 CO. LAW 70 (1998); C. Slaughter, *Corporate Social Responsibility—A New Perspective*, 18 CO LAW 313 (1997).

25. See Barry Rider, *Self-Regulation: The British Approach to Policing Conduct in the Securities Business, With Particular Reference to the Role of the City Panel on Take-overs and Mergers in the Regulation of Insider Trading*, 1 J. COMP. CORP. L. & SEC. REG. 319 (1978).

26. See BARRY RIDER, C. ABRAMS & T.M ASHE, *GUIDE TO FINANCIAL SERVICES REGULATION*, Ch. 1 (3rd ed. CCH 1998), and *BRITISH SECURITIES LAW SERVICE* Vol. 1 Tab 1, (Barry Rider, ed.) (CCH).

system. Hence, even in the early attempts to impose regulation over the embryonic financial markets in London in the Seventeenth Century, it was the criminal law that was invoked to control those accused of malpractice and abuse.²⁷ Consequently, it is perhaps not surprising that virtually no thought was given, during the debate, as to whether it might be appropriate to utilise other legal mechanisms than the criminal law in controlling or at least discouraging insider abuse. Although it is true that even in the United States of America it was not for some time that the civil law started to play a significant role in inhibiting insider abuse, and the reasons for this development were peculiar to the system, the New Deal legislation in the 30s did show ingenuity in utilising alternative mechanisms than the ordinary criminal law.²⁸ For example, the short swing profits rule in section 16(b) of the Securities Exchange Act 1934, albeit not concerned with insider abuse of information as such, was an imaginative attempt to discourage insider speculation without resorting to prohibition and the ordinary criminal law. Of course, given the constitutional position in the United States and the importance of the Securities and Exchange Commission's pivotal role, it is understandable that reliance was not placed on the criminal law even in regard to matters where the criminal law had already intervened, such as in regard to market manipulation. In the British context, however, the desire to inhibit insider abuse has always led us into the criminal law and thus, the problems of the criminal justice system.

III. The Efficacy of the Criminal Law

In 1986 Lord Justice Roskill's Fraud Trial Committee²⁹ reported that the British public had no confidence whatsoever in the ability of the criminal justice system to bring the perpetrators of serious fraud effectively and expeditiously to book. Lord Justice Roskill and his committee added that they considered on the basis of the evidence that they had received, the public was justified in this view. The system just did not work. The reasons why the criminal law has proved ineffective in curbing economically motivated crime are well known and need little mention here.³⁰

27. See G. Gilligan, *The Origins of UK Financial Services Regulation*, 18 Co. LAW 167 (1997).

28. See also D. Fitzsimons, *Controlling Insider Trading—The Civil Approach in New Zealand*, 4 J.F.C. 309 (1997).

29. Report of the Fraud Trial Committee, H.M.S.O. para. 1 (1986).

30. See generally Barry Rider, *Civilising the Law—The Use of Civil and Administrative Proceedings to Enforce Financial Services Law*, 3 J.F.C. 11 (1995),

Where the conduct in question takes place in a commercial or financial environment, the transactions are likely to be complex and difficult for investigators, prosecutors and the tribunal to understand.³¹ Indeed, it is in the interests of the criminal to try and render the circumstances as confusing as possible. This may not only effectively rule out detection, but render a subsequent investigation too difficult or too costly. It may also discourage a prosecutor attempting to present the matter to a court. The ability to involve another jurisdiction at a critical stage in the commission of the crime, or at least in its consummation, provides yet another stumbling block.³² Effective international cooperation in regard to taking evidence and rendering it admissible, although improving, is not efficient and in many instances is in practical terms nonexistent.³³ The traditional criminal law is parochial in its character and reach. Even if jurisdiction is found, the practical difficulties and costs attendant on pursuing a matter which requires evidence from another country often represent a most serious hurdle. In such cases documentary evidence is often crucial and apart from its susceptibility to being rendered unreliable, will be difficult and often expensive to bring before the court. The nature of fraud is such that it will often be some considerable time after the crime, that the agencies of the criminal justice system become involved. This gives those responsible for the crime an opportunity to hide and destroy evidence, to launder the profits and move to a jurisdiction not easily able or perhaps willing to respond to requests for assistance, let alone extradition. Where special legislation is enacted to deal with specific problems, such as insider dealing, the offences are invariably complex and require more evidence, susceptible to even higher standards of proof than the ordinary law.³⁴

In most countries those charged with the responsibility of investigation, prosecuting and trying such cases will often have no or little specialised knowledge of the environment within which the

and Barry Rider, *Fraud in the Financial Markets*, in *THE REGULATION OF FINANCIAL AND CAPITAL MARKETS* (SNP 1990).

31. See generally, *JURIES IN SERIOUS FRAUD TRIALS: A CONSULTATION DOCUMENT*, HOME OFFICE Chs. 1 and 2 (1998).

32. See M. Findlay, *Crime as a Force in Globalisation*, 6 J.F.C. 103 (1998).

33. See Barry Rider, *Policing the International Financial Markets: An English Perspective*, XVI BROOK. J. INT'L L. 179 (1990). See also D. Chaikin & Barry Rider, *Mutual Assistance in Criminal Matters: A Commonwealth Perspective*, Commonwealth Law Ministers, COMMW. SECRETARIAT (London 1983).

34. See BARRY RIDER & T.M. ASHE, *THE FIDUCIARY, THE INSIDER AND THE CONFLICT* Ch. 13 (Brehon, Sweet & Maxwell 1995).

crime has occurred and may be unpractised in the relevant law. On the other hand, those accused of such crimes, which often carry relatively little stigma, have access to such expertise and cooperation that their ill-gotten gains affords. Invariably there are no "real" victims or if there are, they may well have been so disadvantaged by the fraud, as to be impecunious and of no real threat to the wrongdoers. Indeed, the more vicious the fraud the less likely there are to be victims left around who are going to be able to challenge what has occurred. In the case of insider dealing, as we have already seen, it is even difficult to characterise those who happened to deal with the insider or his nominee as a victim in any real sense of the world, let alone expect such an individual to respond to the "crime" with the degree of outrage that might better fuel official action. It must also be said that in a good many countries, for this and other reasons, even when a matter is brought before the courts, judges and even juries do not consider the wrong particularly egregious and the penalties imposed are on occasion derisory.³⁵ This does not send out a particularly appropriate signal in terms of denunciation, or for that matter to those who have spent possibly years pursuing the matter. The development of electronic trading through markets where notions of trust and territoriality are meaningless, exacerbates the problems.³⁶ Added to this is the increasing awareness on the part of criminals, and even organised crime, that economic crime is both high in reward and low in risk.

The agencies of the criminal justice system may not always be well suited to address, or for that matter even perceive, the sensitivities of complex economic activities.³⁷ In most jurisdictions, and Britain is no exception in this regard, the detection and investigation of crime is a matter for the ordinary police. In situations where the crime may not be obvious, except in the accumulation of wealth, and there are not articulate and well

35. See generally T.M. ASHE & L. COUNSELL, *INSIDER TRADING* Appendix 5 (2nd ed. 1993). See also J. Rakoff & J. Eaton, *How Effective is U.S. Enforcement in Detering Insider Trading?*, 3 J.F.C. 283 (1996). See also J. SUTER, *THE REGULATION OF INSIDER DEALING IN BRITAIN*, (Butterworths 1989).

36. See REPORT ON JURISDICTION AND THE REGULATION OF FINANCIAL SERVICES ON THE INTERNET, FINANCIAL LAW PANEL (1998); G. P. Rutledge, *The Internet and US Financial Markets*, 6 J.F.C. 129 (1998); N. Deirne & A. Herring, *Financial Services Regulation and the Internet in the UK*, 19 CO. LAW 264 (1998); and BARRY RIDER, *THE PREVENTION AND CONTROL OF FRAUD AND ABUSE IN ELECTRONIC SECURITIES MARKETS* (E.S.I. 1995).

37. Barry Rider, *Combating International Commercial Crime* 217 (L.M.C.L.O. 1985), and Barry Rider, *The Promotion and Development of International Cooperation to Combat Commercial and Economic Crime*, Commonwealth Law Ministers, COMMW. SECRETARIAT (London 1980).

positioned victims, then it is perhaps hardly surprising that traditional processes for detection and identification of crime are less than effective. Ordinary law enforcement agencies do not have access to the environment within which such activity as insider abuse occurs. The social, financial and even intellectual barriers are such as to render most police agencies wholly ill-suited to the task of investigation, let alone detection. This is not to belittle the operation and culture of traditional policing, but to recognise that police agencies because of their position in society, the resources available to them, the career structures within which their officers are bound to work, the political and other pressures to respond in a manifest way to the more obvious and thus, in popular sentiment more dangerous crimes in the street, such agencies are ill-placed to make the commitment to pursue such matters as insider trading. Traditional law enforcement is in practical terms almost institutionally disabled from effective policing of crime in the financial markets. Of course, this is not to discount or undervalue the tremendous efforts of individual officers who are able and willing to invest time, often their own, and effort in making out a viable case, however, sadly the vagaries of the legal system and perhaps the unsuitability of the ordinary criminal trial process for dealing with such cases, invariably results in acquittal or a derisory sanction. This, as we have already noted, does little to reinforce the commitment of officers in personal or professional terms to take these cases seriously. For innumerable reasons, not just associated with resources, but perhaps even more significantly the deep seated fear of special police with special powers, or at least special learning, few jurisdictions that have attained any success in enforcement have been able to retain this capability within the ordinary structure of law enforcement. Similar problems have been encountered in regard to the development of criminal intelligence and in particular the control of terrorism. On the other hand, few states are prepared to allow those outside the discipline of the police to wield coercive powers of investigation, interdiction and arrest. Thus, the irony is presented, whereby those who might be trusted with the weapons needed to police the criminal law, are unable to use them, and those who might be not sufficiently trusted, often by the very legal system, to use them.

At the end of the day, the criminal law, to an extent greater than any other area of the law, involves the State, with all its powers and privileges, being at odds with the individual. The accused risks not only being subjected to the indignities and costs of the processes of investigation and trial, but deprivation of property

and incarceration. Of course, our jurisprudence teaches us that the criminal law is there to protect the well-being of all within society. Therefore is not properly represented as the State against the individual. However, we all know that reality is one thing and classroom jurisprudence quite another. In the case of economic crime, or even the wider context of so called "white collar crime," the courts and in particular the judiciary have shown sympathy to those who have been subjected to the rigors of the ordinary processes of the criminal justice system. This is not merely a matter of the tribunal being unconvinced that such crimes create "real" harm to anyone deserving of great pity, but often the identification by those in the tribunal with the social position and even aspirations of the accused. While evidence, in the transparent and accountable world in which we now live, is hard to come by, save by anecdote, there is a real and popular concern in many countries, including Britain, that not all members of the judiciary, for example, are sufficiently dispassionate in regard to such matters. Successful tax lawyers, who spend most of their professional life, advising very rich clients how to avoid paying tax, may well, after promotion to the bench, find difficulty in manifesting their anger against, for example, a corporate executive who "happens" to sell out his shares at the wrong time.³⁸ Indeed, selling, even while in possession of inside information, for the purpose of avoiding tax rather than profiting by virtue of the information, may well be deemed unobjectionable. Greed is a nice and very fact specific concept. Of course, much has been done, in many countries, to make judges and officials more aware of the social and economic implications of such matters, but it is hard to explain why a self-confessed fraudster who was accused of losing investors millions of pounds received a punishment of only 180 hours community service.³⁹ It is also the case that, justifiably or not, some jurisdictions have acquired the reputation for taking a rather different view than others, on such matters as insider dealing. For example, in a case not too long ago, a District Judge in New York referred to the view that in Hong Kong to be accused of insider dealing meant you were being fast

38. See *R v. Charlton, Cunningham, Kitchen & Wheeler* S.T.C. 1418 (1996) discussed by M. Bridges, P. Atkinson, R. Rhodes & R. Bosworth-Davies, in 2 *J. OF MONEY LAUNDERING CONTROL* 197 (1999). See also J. Ungood-Thomas & E. Hanzic, *Director—Judges Break the Rules Over Business Links*, *SUNDAY TIMES*, Mar. 18 1999.

39. *Roger the Dodger, Convicted After £34m Crash, But He Gets 180 hrs Community Work*, *THE SUN*, Nov. 27 1993.

tracked for an honour from the Queen.⁴⁰ While in truth such a comment is wholly unjustified, as Hong Kong is a jurisdiction that has long considered insider dealing a serious abuse and done much to discourage it,⁴¹ the fact remains that there is, at least in some very influential circles, a perception to the contrary.

IV. Public Markets: Public Law

Insider dealing was made, as we have seen, a specific criminal offence under Part V of the Companies Act 1980 in Britain.⁴² The law was slightly amended and reenacted in the Company Securities (Insider Dealing) Act in 1986⁴³ and then completely recast, to take account of the European Council Directive on Insider Dealing, in the Criminal Justice Act 1993.⁴⁴ The conceptual justification for prohibiting insider dealing in the pre-1993 law was, as has already been pointed out, the importance of promoting and preserving public confidence in the integrity of the financial markets. Therefore, the offences were confined to dealings that took place on a securities exchange or through or with a professional intermediary. Furthermore, it was simply assumed that it is the criminal law that is most appropriately deployed in vindicating the integrity of the public markets.⁴⁵ Little if any thought or

40. See *Nanus Asia Inc. v. Standard and Chartered Bank*, 1 H.K.L.R. 396 (1990) (referring to District Judge Owen's comments).

41. See Barry Rider, *The Regulation of Insider Trading in Hong Kong*, 17 MAL. L.R. 310 (1975), continued in 18 MAL. L.R. 157 (1976); Barry Rider, *Insider Dealing—Hong Kong Style*, 128 N.L.J. 897 (1978); and Barry Rider, *The Control of Commercial Crime in Hong Kong—Proposals for Reform*, HONG KONG GOV'T, LEGAL DEP'T (1980).

42. For a discussion of the law, see BARRY RIDER, *INSIDER TRADING*, (Jordans 1983). For earlier legislative proposals see BARRY RIDER & H.L. FRENCH, *THE REGULATION OF INSIDER TRADING*, (Macmillan 1979); Barry Rider, *Companies Bill 1978; Insider Trading*, 128 N.L.J. 1236 (1978); and Barry Rider, *The Conduct of Company Directors*, 128 N.L.J. 27 (1978). See also D. Sugarman, *The Regulation of Insider Dealing*, in Barry Rider (Ed) *The Regulation of The British Securities Industry*, (Oyez 1979).

43. See BARRY RIDER, C. ABRAMS & D. CHAIKIN, *GUIDE TO THE FINANCIAL SERVICES ACT Ch. 7* (C.C.H. 1987).

44. See BARRY RIDER AND T.M. ASHE, *INSIDER CRIME* (Jordans 1993); and BARRY RIDER AND T.M. ASHE, *THE FIDUCIARY, THE INSIDER AND THE CONFLICT* (Brehon, Sweet & Maxwell 1995).

45. See for example the dismissal by the Department of Trade of the suggestion by the House of Commons Select Committee on Trade and Industry that civil sanctions should be available against insider trading, on the basis that the criminal law is the appropriate law for protecting the public interest; *COMPANY INVESTIGATIONS: GOVERNMENT'S RESPONSE TO THE THIRD REPORT OF THE HOUSE OF COMMONS TRADE AND INDUSTRY COMMITTEE*, C.M. 1149 1989-90 Sess. (1990); *COMPANY INVESTIGATIONS, THIRD REPORT OF THE TRADE AND INDUSTRY*

consideration was given to any other conceptual basis for regulating insider abuse or invoking any other form of control of regulation. Even in the discussion that took place in Britain during the decade that preceded the 1980 Companies Act precious little thought was given to justifying an approach to control other than on the basis of public confidence.⁴⁶ Of course, those who advocated legal controls pointed out that unrestricted insider dealing allowed those in a position of trust to abuse the confidence that had been reposed in them and perhaps even encouraged them to hold back disclosure of price sensitive information.⁴⁷ Indeed, some contended that to allow insiders to control the flow of information on to the market provided them with a significant opportunity to manipulate prices. Surprisingly little attention was, however, given to the relationship of disclosure obligations to the abuse of undisclosed information. It was simplistically assumed that by outlawing the use of inside information, those responsible for disclosing such information to the market, would see no personal advantage in delaying reporting and thus, information would be brought through into the market. To characterise such views as naive is an understatement. Firstly, it is by no means the case that information that would normally be required to be disclosed to the market, under legal, contractual or self-regulatory obligations, is always of the character of that which would fall within the scope of the law against insider abuse. It is probable that what might be described as tentative information⁴⁸ has a much greater significance in personal dealings, and this might neither have the specificity or materiality to be regarded as disclosable, let alone sufficient for the imposition of criminal liability. Furthermore, as the US Federal Courts have long recognised,⁴⁹ those in possession of information, that might fall within the scope of the offence, will rarely be in a position to activate the relevant corporate or other disclosure procedures.

COMMITTEE, H.M.S.O. (1990).

46. See Barry Rider, *Insider Trading—A Question of Confidence*, THE LAW SOCIETY'S GAZETTE, vol. 77, No 5. (1980). See also Barry Rider & H.L. French, *Should Insider Trading be Regulated—Some Initial Considerations*, 95 S.A.L.J. 79 (1978).

47. See Barry Rider, *The Enforcement of Corporate Integrity with Particular Reference to the Role of Disclosure*, L.C.B.; GOWER, L. LOSS & A.A. SOMMER (eds.), NEW TRENDS IN COMPANY LAW DISCLOSURE, (L. and Bus. Inc. 1980).

48. See A. Besorai, *The Insider and Tentative Information*, THE FIDUCIARY, THE INSIDERS AND THE CONFLICT (Brehon, Sweet & Maxwell 1995).

49. *United States v. Chiarella*, 445 U.S. 222 (1980); *Dirks v. SEC*, 463 U.S. 646 (1983); but see *United States v. Carpenter* 791 F.2d 1024 (2nd Cir. 1986). See *US v. O'Hagan* No 99-842 (1997) and *K. McCoy*, 18 CO. LAW 94 (1997) and 18 CO. LAW 335 (1997).

Indeed, to disclose the relevant information might itself result in a breach of confidence.⁵⁰ Therefore, the choice to disclose or abstain from trading is unreal. In practice, for the vast majority of primary or access insiders and those in secondary positions, there is no choice, as they have no control or even influence over the mechanisms for disclosure. Their choice is simply to abstain from disclosure or cheat. Thus, the information either remains outside the market or is appropriated for improper dealings. The notion, propounded by Professor Henry Manne, that insider dealing, both directly and through induced and "tailgate" trading, brings the information, or at least knowledge of its significance, into the market has never been substantiated, save in one respect. It is true that as a consequence of effective stock watch programmes, official and unofficial, knowledge that there is undisclosed information about may be signalled. The result of this signalling, may not always be that the information will be brought into the market. It is also the case that few systems do have the ability to pick up, unassisted by other devices and procedures, trading that is based on inside information. The signalling that occurs, when it does, is often a result of a number of factors.

V. Organised Insiders

The prohibitive approach to insider dealing may encourage the exchange and even arbitrage of information. To be fair to Professor Manne, he himself identified this as a real possibility, although it was dismissed as fanciful until a series of cases in the USA and Britain during the late Seventies and early Eighties demonstrated the existence of a veritable "market" in price sensitive information. Items of information were syndicated and exchanged, on occasions even bartered for drugs or other favours. More recently, investigations not only in the USA, but also Britain, Germany, France, Japan, Hong Kong and Australia have indicated the involvement of organised crime groups, not only in obtaining price sensitive information through intrusive and exploitative action, but then its marketing. As most systems and procedures for detection depend in the final analysis on identifying a nexus or relationship, collateral or otherwise, between the individual who draws down the profit and a privileged source, whether legitimate or not, the syndication and disassociation of information, effectively places such operations beyond the reach of traditional methods of

50. See Barry Rider, *The Abuse of Inside Information*, 127 N.L.J. 832 (1977).

control. In effect the information is being laundered. To some extent the process and certainly the result is not too dissimilar to the laundering of the proceeds of crime. In cases where it is necessary to reinvest at least part of the proceeds of crime in a continuing criminal enterprise or evade the risks of confiscation or other risks of interference, it is necessary to disassociate the profit from its method of creation. In other words, the nexus between the crime generating the profit and the wealth that represents the profit, must be broken or at least sufficiently obscured so that those seeking to exhibit the connection are either discouraged or frustrated.⁵¹ In fact the debate on controlling the laundering of the proceeds of crime is not unconnected with that relating to insider abuse. Although these topics are distinct and have not been associated in the minds of commentators, it is not, in the view of the present author, merely by chance that legislation directed against money laundering and insider dealing is often linked. The same is true in regard to arrangements for international mutual assistance.⁵² Perhaps given the increasing amount of evidence, or rather intelligence, that is coming to light indicating that serious criminals have moved into financial crime and in particular insider dealing, it is appropriate to dwell on this matter a little longer.

While care always needs to be taken not to sensationalise either the extent or impact of organised crime activity, it is sadly a fact that the activities of organisations devoted to accumulating and controlling considerable amounts of wealth is today a real threat to world stability.⁵³ The vast amounts of money are generated through illicit trafficking in drugs and other contraband is so great as to play a real role in the world economy.⁵⁴ For a number of reasons it has

51. See Barry Rider, *The Practical and Legal Aspects of Interdicting the Flow of Dirty Money*, 3 J.F.C. 234 (1996); see generally T.M. ASHE AND BARRY RIDER (eds.), *MONEY LAUNDERING CONTROL*, (Brehon, Sweet & Maxwell 1997).

52. See generally Barry Rider, *Blindman's Bluff—A Model for Securities Regulation*, in *EMERGING FINANCIAL MARKETS AND THE ROLE OF INTERNATIONAL FINANCIAL ORGANISATIONS* (Kluwer 1996).

53. See generally Barry Rider, Memorandum 15, *Organised Crime in the United Kingdom: A Personal Perspective*, in *ORGANISED CRIME, MINUTES OF EVIDENCE AND MEMORANDA, HOME AFFAIRS COMMITTEE, HOUSE OF COMMONS, H.M.S.O.* (1994); *Organised Crime*, THIRD REPORT OF THE HOME AFFAIRS COMMITTEE, HOUSE OF COMMONS, H.M.S.O. (1995); and A. Shipman & Barry Rider, *Organised Crime International*, SECURITY AND DEFENCE (Cornhill Pub. 1987).

54. See BARRY RIDER & T.M. ASHE (eds.), *INTERNATIONAL TRACING OF ASSETS*, vol. 1, Ch. 1 (Sweet & Maxwell 1997); BARRY RIDER & C. NAKAJIMA, *MONEY LAUNDERING SERVICE* Ch. 8 (C.C.H. 1999). See also Barry Rider, *Organised Crime, Expert Memorandum to Commonwealth Law Ministers*, COMMW. SECRETARIAT (1983), and Barry Rider, *TRANSCRIPT OF EVIDENCE TO*

become desirable for these organisations to launder this wealth and it is to the financial markets that they are increasingly drawn. Their reliance on financial intermediation has brought them into the financial world as customers, but increasingly as providers of capital and services⁵⁵. For many years, the more astute criminal organisations have recognised that financial fraud is attractive not only in terms of the rewards that it generates but also because it exposes them to far less risk of interdiction. Organised crime has been involved for some considerable time in boiler room operations and market manipulation.⁵⁶ The profits that can be made through exploiting, directly or indirectly, price sensitive information when compared with the minuscule risk of punishment, has rendered insider trading particularly attractive. Such organisations do not, however, seek to rely upon the odd tip from an insider, instead they have gone about acquiring inside information themselves. In some cases they have installed informants within companies, perhaps as a secretary or as a cleaner, in others they have extorted information from executives or utilised sophisticated electronic listening devices. In one or two instances organised crime has been bold enough to intervene directly in management and seek to influence the operation and timing of corporate disclosure. Those who have made significant profits through insider dealing have also been willing to turn to organised crime groups to assist them in laundering the proceeds of their crime. Others have bartered and sold inside information to organised crime for drugs or for cash. There are also examples of individuals who wish to exploit inside or privileged information coming together and structuring their relationship in such a manner as to be indistinguishable from an organised crime operation. Indeed, as early as 1984 the then Head of Enforcement⁵⁷ at the London Stock Exchange reported that there were highly sophisticated dealing syndicates operating on the

THE PUBLIC SAFETY AND JUSTICE SELECT COMMITTEES OF THE SOUTH AFRICAN PARLIAMENT, Capetown, Aug. 1998.

55. See Barry Rider, *The Financial World at Risk; The Dangers of Organised Crime, Money Laundering and Corruption*, 9 *MANAGERIAL AUDITING J.* 3 (1993); Barry Rider, *The Enterprise of Crime*, in *MONEY LAUNDERING CONTROL* (Roundhall, Sweet & Maxwell 1996).

56. See D. FRANCIS, *CONTRAPRENEURS* Pt. 1 (Macmillan 1988); Barry Rider, *Taking the Profit Out of Corruption*, *CORRUPTION AND DEMOCRACY*, C.O.L.P.I. (1994). See also *Fraud Trial Unmasks Mob Muscling in on Wall Street*, *SUNDAY MORNING POST*, Mar 21, 1999.

57. Mr. Robert Wilkinson. Mr. Wilkinson came in for a good deal of criticism for being so blunt. However, evidence came increasingly to light during the 1980s to prove the accuracy of his observations.

Stock Exchange through complex webs of nominees and offshore accounts. The City Panel on Take-overs and Mergers had drawn attention to the use of offshore nominees and the like, frustrating their own investigations a decade before this. The experience of countries such as Canada, Japan and Australia in this regard has been even more alarming.

VI. Taking the Profit Out of Insider Abuse

While it is obvious that many forms of crime are motivated by economic gain, apart from one or two exceptions, there were few legal precedents designed to take the profit out of crime. It is true that in early English law conviction for a felony might result in the confiscation of property in favour of the Crown. But this had rather more to do with notions of feudal responsibility and raising revenue, than the control of crime. With the development of criminal activity which requires the reinvestment of the proceeds of crime, back into the enterprise, it has become far more important for law enforcement agencies to address the profitability of criminal activity. By interrupting the flow of funds back into the continuing criminal enterprise the criminal activity in question may be destabilised or even in some cases undermined. Consequently, today one of the most significant strategies in fighting profitable crime is confiscating property which can be taken to be the proceeds of crime. The more efficient such procedures are the greater incentive there is for criminal organisations to try and place their ill-gotten gains beyond the reach of the law, or at least make it more difficult for those seeking to trace it to prove to the satisfaction of a court that the wealth in question represents the proceeds of a specific crime. Hence the need to launder the proceeds of crime. Most countries and international organisations have enthusiastically espoused this strategy and laws providing for the confiscation of the proceeds of crime are commonplace.⁵⁸ Most countries have such laws in relation to drug related crimes and an increasing number apply the same approach to all serious crime. These laws are reinforced by others, which render the handling and laundering of such wealth a specific criminal offence. The breadth and scope of such provisions are impressive. For example, if a man took profits that he made through insider dealing on the New York Stock Exchange and then bought a house in London in which his

58. For the substantive law of most jurisdictions, see BARRY RIDER & T.M. ASHE (eds.) *INTERNATIONAL TRACING OF ASSETS* (Sweet and Maxwell 1997); BARRY RIDER AND C. NAKAJIMA, *MONEY LAUNDERING SERVICE* (C.C.H. 1999).

girl friend lived, provided she knew of the circumstances, she would under English law be susceptible to a charge under the anti-money laundering laws.⁵⁹ It is, therefore, perhaps hardly surprising that in the USA prosecutors are increasingly prepared to add or even concentrate their efforts, on a charge of illicit money laundering in cases of insider abuse or financial fraud. Often they will also seek to invoke the evidential and procedural advantages of legislation designed to deal with a pattern of criminal activity by organised crime.⁶⁰ Although the Racketeer Influenced and Corrupt Organisation statute (RICO)⁶¹ was designed to deal with the activities of traditional organised crime, such as la cosa nostra, it has proved particularly useful in dealing with economic crime perpetrated by those who would not normally be thought of as members of organised crime groups.⁶²

These new laws and the regulatory and compliance obligations that they ordain, have imposed a very considerable burden on all those who mind other peoples' money and in particular upon the financial services industry.⁶³ Indeed, it is arguable that they have had as much impact on the way in which business is actually conducted in the financial sector than those laws which were enacted specifically for the markets and industry. For example, the obligations to know your customer and to varying degrees vouch for the integrity of his transactions, have had a profound impact upon the way business is done. Often little or no thought has been given to the inter-play between these new laws and existing obligations in the civil law.⁶⁴ Would the obligation to know about a client's circumstances and transactions impact on the suitability doctrine. Ironically, it was in the USA that the Stock Exchange rules, designed to ensure that investment advice is suitable to the circumstances of a client,⁶⁵ were employed by the regulators to

59. See generally R. BOSWORTH-DAVIES AND G. SALTMARSH, *MONEY LAUNDERING* Ch. 5 (Chapman & Hall 1994).

60. See J. H. ISRAEL, E. S. PODGOR & P. BORDMAN, *WHITE COLLAR CRIME* Ch. 6 (West Publishing 1996).

61. Organised Crime Contract Act, Title IX (1970).

62. See, e.g., *United States v. Davis*, 707 F.2d 880 (6th Cir. 1983); *Mark Thatcher Faces \$3 million Racketeering Lawsuit in Texas*, THE OBSERVER, Oct. 2, 1994.

63. See generally Barry Rider, *The Limits of the Law: An Analysis of the Interrelationship of the Criminal and Civil Law in the Control of Money Laundering*, 2 J. of Money Laundering Control 209 (1999). See C. Nakajima, *Money Laundering and Constructive Liability*, THE CORPORATE DIMENSION (Jordans 1998).

64. See Barry Rider, *supra* note 63.

65. See N.Y.S.A. Rules and Regulations 405, and BARRY RIDER & H.L.

develop the obligation on intermediaries to know their clients. They could not demonstrate that they had taken steps to ensure that their advice or management was suitable if they had not taken steps to ascertain their clients' circumstances and needs.⁶⁶ In Britain the relationship of the so called "know your client" rule to a fast developing area of the law which imposes liability on those who receive property in breach of trust or who give dishonest assistance in the laundering of such property is far from clear.⁶⁷ Indeed, it may well be the case that the obligation to seek out those who have a claim against such property, conflicts with the obligation imposed by the criminal law not to disclose to the authorities, a suspicion that a crime has been committed.⁶⁸ Given the intrusion of the criminal law into the financial and commercial world and the relative ignorance of public lawyers of this area of activity, and for that matter of commercial lawyers of the responsibilities of the criminal justice system, it is perhaps not surprising that there is so much potential for conflict. Of course, in an area of activity that is so international in its operations, the potential for conflict not only between domestic laws, but with the requirements of other jurisdictions is so much greater.

The pursuit of insiders suspected of abusing inside information, particular by the US authorities, has highlighted a number of deficiencies in the then arrangements for international mutual legal assistance.⁶⁹ In Britain, as has already been mentioned the self-regulatory authorities protested that it was because of the lack of cooperation of the then Swiss authorities and thus, their inability to seek information from Swiss banks, that frustrated their ability to satisfactorily investigate cases of suspected insider dealing. It was

FRENCH, *THE REGULATION OF INSIDER TRADING* Ch. 16 (Macmillan 1979).

66. Under section 178 of the Financial Services Act 1986, an inspector appointed to inquire into a suspected case of insider dealing is entitled to demand from an agent or nominee the details of his principal and it is expressly provided that it is not an excuse for that person to contend that he does not know or, for that matter, the laws of another jurisdiction would impose liability upon him for an unauthorised disclosure, provided those laws would permit disclosure had permission been obtained at the start of the relevant relationship. *See generally*, BARRY RIDER, C. ABRAMS & T.M. ASHE, *C.C.H. GUIDE TO FINANCIAL REGULATION* 238 (3rd Ed. C.C.H. 1998).

67. *See* Barry Rider, *Liability for Conflicts of Interest—An English Problem, in DEVELOPMENTS IN EUROPEAN COMPANY LAW* (Kluwer 1996).

68. *See* C. NAKAJIMA, *CONFLICTS OF INTEREST AND DUTY* (Kluwer 1999).

69. *See generally* D. Chaikin, *Fraud, Securities Laws and Extraterritoriality, in THE REGULATION OF THE BRITISH SECURITIES INDUSTRY* (Oyez 1979); Barry Rider, *Policing the International Financial Markets*, XVI *BROOK. J. INT'L L.* 179 (1990).

this factor which persuaded many in the City of London to call for the intervention of law, reinforced by powers of investigation which were legally sanctioned. Of course, the mere conversion of investigatory powers from the realm of contract law into that of public law, is not always helpful when the information or evidence is out of jurisdiction. Indeed, it may well be better in such cases to rely upon informal and therefore almost “unaccountable” procedures. When legal and coercive powers are used, then it is entirely appropriate that those utilising them are subject to scrutiny and control by the legal system. Where, however, the inquiry is conducted without the benefit of legal sanction, on an informal basis, then it may be argued there is less justification for such control and in any case the process is far less visible.⁷⁰ In fact, obtaining information from banks and other intermediaries is not in the main a problem. It is always possible to find a weak link or someone who is prepared, for a price to be indiscreet. The difficulty, for those charged with the enforcement of the law, is rendering such information admissible and useable in their own domestic legal system.

Certainly, one of the main stumbling blocks to the effective investigation and then prosecution of economic crime has been the impenetrability of bank secrecy and confidentiality laws in countries which have made it their business to hide the details of shady and illicit transactions.⁷¹ Therefore many of the initiatives that have taken place at both bilateral and multilateral levels to promote meaningful mutual assistance, have focussed on the crimes of insider dealing and money laundering.⁷² The institutional imperatives behind such initiatives are not without interest. In the

70. This author is not necessarily commending such an approach. Indeed, there are profound issues, not least of human rights, when those not subjected to the discipline and scrutiny of the law are permitted to engage in enforcement related activity. In fact, he has criticised on a number of occasions the practise that the Securities and Investments Board (the predecessor of the Financial Services Authority in the UK) adopted of instructing private investigators and then on occasion arming them with the SIB's own legal investigatory powers. See Barry Rider, *Policing the City—Combating Fraud and Other Abuses in the Corporate Securities Industry*, 41 CURRENT LEGAL PROBLEMS 47 (1988).

71. See generally M. Kenney, *The Penetration of Asset Protection Trusts*, 6 J.F.C. 111 (1998), and Barry Rider, *Taking Money Launderers to the Cleaners*, PRIVATE CLIENT BUSINESS 134, 201, 307 (1996). See also G. Moscarino and M. Shumaker, *Beating the Shell Game; Bank Secrecy, Laws and their Impact on Civil Recovery in International Fraud Actions*, 18 CO. LAW 177 (1998), and A. EDWARDS, REVISION OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES Part 1 (1998).

72. See generally, T. Newkirk, *The SEC's International Enforcement Programme: Gathering Evidence outside the USA*, 6 J.F.C. 234 (1999).

USA the Securities and Exchange Commission did go through a period during which certain of its officials elevated the fight against insider abuse to the level of a crusade. Whether this was due to a real concern to present the good face of capitalism, or perhaps more cynically to carve out an international enforcement role, with all the kudos that this involves, is a matter for history. In fact, it was the extraordinary efforts that were made by the Americans to police their anti-insider dealing law, which pioneered the development of mutual assistance through memoranda of understanding and in particular in regard to inter-agency cooperation and exchange of intelligence. This is even more impressive, when it is remembered that so few cases of insider abuse in the USA were or, for that matter, are pursued as criminal prosecutions.

Why agencies, such as the U.S. Securities and Exchange Commission placed so much importance on outlawing and pursuing insider dealing at an international level is a matter for debate.⁷³ There can be little doubt that in part, the initiative was political, motivated and justified by institutional and even the personal and career aspirations of ambitious individuals. There are those, however, who have discerned a rather deeper significance. There can be little doubt that over the last two decades a number of agencies charged not only with protecting the national interest in matters of defence and security, but also traditional law enforcement, have increasingly recognised the importance of information pertaining to financial transactions. This has proved to be particularly useful in developing intelligence on the structure and operations of organised crime and for that matter terrorism. In some respects it has proved easier and probably more acceptable for enforcement agencies to pressurise foreign banks and institutions, often through the use of civil enforcement powers, to cooperate in providing relevant information in the context of inquiries into suspected financial misconduct, such as insider dealing, than in regard to certain other areas of concern. Although it is probably unjustified to contend that insider dealing cases have been utilised as convenient Trojan horses to open up foreign regulatory and financial systems, it would be equally misconceived to try explain the extraordinary efforts that US agencies have gone to, simply on the basis of their desire to pursue those who abuse

73. See Barry Rider, *Global Regulatory Trends—The Changing Legal Climate*, MONEY LAUNDERING, ASSET FORFEITURE AND INTERNATIONAL FINANCIAL CRIMES (Oceana 1994).

inside information. In the case of Switzerland, despite an existing mutual assistance treaty, the USA forced the Swiss authorities to broaden the scope of cooperation to include matters, which at the time the Swiss did not consider to be a criminal, by pushing several major insider dealing cases to the point of diplomatic embarrassment.⁷⁴ Pressure was also placed on a number of other European countries as well as Japan. In all cases, the USA's concern to facilitate the fight against insider dealing grew into a broader initiative against the proceeds of crime and in particular drug related crime.⁷⁵ Consequently, it is perhaps not surprising that in the minds of legislators, control of insider abuse becomes linked to the fight against organised crime, by depriving criminals of their illicit profits. In Britain this is not simply a matter of both issues being addressed in the same piece of legislation; The Criminal Justice Act 1993. The Draft Financial Services and Markets Bill 1998 provides a specific mandate for the Financial Services Authority to concern itself, as one of its statutory objects, with the reduction of financial crime. Clause 6 of the Draft Bill defines financial crime to include, inter alia, "misconduct in, or misuse of information relating to, a financial market; or handling the proceeds of crime."

The experience of the UK and for that matter most other countries, with the notable exception of the USA, in policing anti-money laundering law has not been markedly different to that pertaining to insider dealing. The same is also true in regard to confiscation of the proceeds of crime. Despite the fact that in Britain there have been laws providing for the confiscation of the proceeds of drug related crime since 1986 and all profitable crimes since 1988, the amount of money and value of property actually confiscated is derisory. Under this legislation,⁷⁶ since the relevant provisions came into force the British authorities have managed to confiscate less than £42million of the proceeds of crime.⁷⁷ Although it is notoriously difficult to even guesstimate the amount of wealth passing through Britain that might represent the proceeds of crime, it has been said by a former head of the Legal Directorate of the

74. See, e.g., *SEC v. Banca Della Svizzera Italiana*, 92 FRD 111 (S.D.N.Y. 1981).

75. See generally J. Tigue, *New Treaties Making Inroads into Foreign Bank Secrecy*, N. Y. L. J., Jan. 15, 1998.

76. See generally, A. MITCHELL, S. M. E. TAYLOR & K. V. TALBOT, *CONFISCATION AND THE PROCEEDS OF CRIME* (Sweet & Maxwell 1997).

77. *THIRD REPORT OF THE HOME OFFICE WORKING GROUP ON CONFISCATION, CRIMINAL ASSETS 12-13* (1998).

British intelligence and security services that the figure is in the order of £200 billion a year.⁷⁸ If this is anywhere near the truth, it indicates that a strategy based on taking the profit out of crime, through the ordinary criminal justice system, just does not work.⁷⁹ It should also be remembered that the total cost to the financial and banking community⁸⁰ of complying with the onerous anti-money laundering laws has been put in the region of £300 million a year. Of course, it would be wholly wrong to attempt to evaluate the efficacy of the anti-money laundering regime solely on the basis of how much money had been confiscated, as this involves a host of different issues. On the other hand, the results do put yet another question mark against the efficacy of the traditional criminal justice system's ability or competence, to deal with misconduct in the financial sector.

VII. Confidence—A Precious Commodity

Returning to the justification for regulating insider abuse in Britain, by focussing on the time honoured responsibility of the State to protect and nurture confidence in the integrity of the markets, those who propounded the need for regulation excused themselves from the need to seek out, let alone hearken to any empirical, or for that matter, any data. If we accept that most ordinary people consider taking advantage of inside information, obtained by virtue of a privileged position, is unfair, then in the world of practical politics, it does not really matter if the unfairness cannot be rationalised in legal terms. Nor for that matter, whether anyone is really hurt by the practice. It is enough to justify our concern, that the media focus, as they inexorably do, on the unfairness of insiders taking advantage of their position. This will tend to underline the unfairness to others in the market and alienate investors. It follows, that the State as guardian of the public good, has the right if not the obligation to intervene and take action to curb insider abuse. We are in the realm of sophistry and cosmetic surgery. Even if, in purely pragmatic terms, we consider the perception insider dealing occurs and is regarded as a matter of popular sentiment, as unfair, it does not necessarily follow that the State needs to intervene through the criminal law, or for that matter

78. See J. Adams, *£200bn in Drugs Cash Heads for London Markets*, SUNDAY TIMES, Nov. 19, 1995.

79. See Barry Rider, *Taking the Gloves Off*, 2 J. MONEY LAUNDERING CONTROL 196 (1999).

80. See generally N. Clark, *The Impact of Recent Money Laundering Legislation on Financial Intermediaries*, 3 J.F.C. 131 (1995).

the legal system. The problem is, that if the State does seek to utilise the law to vindicate and protect confidence in the integrity of the market, and then the law is clearly unable to produce tangible results, we are exposed to the danger of transferring the risk of loss of public esteem from the markets to the legal system. Cosmetics can be expensive, and at best merely put off the day of reckoning. In Britain as the primary method for controlling the abuse of inside information is the criminal law, it is not surprising that the media and politicians tend to judge its efficacy in terms of the number of convictions that are secured. Of course, this takes little account of the normative and educative effect of the law.⁸¹ Furthermore, it is at least arguable, although in the present context hardly convincing, that insofar as a proven case of insider abuse indicates a break down in the compliance procedures designed to discourage such abuse, relatively few convictions may indicate effective prevention. The problem with such a positive view of the statistics, is that The Stock Exchange alone identifies nearly three hundred suspicious cases a year. Since 1980, when insider dealing was first constituted a specific criminal offence in Britain, there have been forty six prosecutions. In thirty of these convictions have been recorded. While this is not a bad conviction rate, the majority of those convicted pleaded guilty. In the vast majority of cases no attempt was made to quantify, let alone confiscate the insider's profit and it has been said that in only two cases was the fine greater than the amount by which the insider profited. The considerable costs involved in pursuing a case of insider dealing must also be borne in mind. Where inspectors are appointed under section 177 of the Financial Services Act 1986, the statutory investigation may well cost in excess of £150,000.⁸² Furthermore, criticism has also been voiced as to the time that such investigations can take. It would be relatively easy to present these facts in such a way as to place a significant question mark against the efficacy and role of the criminal justice system in this area of the law.

Little if no discussion has taken place, as to why the public or

81. See, e.g., Barry Rider, *Insider Trading: An English Comment in New Zealand*, in *ESSAYS ON INSIDER TRADING AND SECURITIES REGULATION* (Brooker 1997); Barry Rider, *Insider Trading, Professional Responsibility*, in *LEGAL RESEARCH FOUNDATION INC*, (1987); and Barry Rider & C. Nakajima, *A Comparative Analysis of Anti-Insider Dealing Legislation*, in *COMMERCIAL LAW IN A GLOBAL CONTEXT* (Kluwer 1998).

82. See generally, *Memoranda Submitted to the House of Commons Select Committee on Trade and Industry*, in *COMPANY INVESTIGATIONS, THE THIRD REPORT OF THE TRADE AND INDUSTRY SELECT COMMITTEE, HOUSE OF COMMONS* (H.M.S.O. 1990).

that part of the public which may be considered to be leaders of public opinion, consider insider dealing bad or unfair. It is possible to invoke notions of unjust enrichment and the like, but it is rather more likely that the predominant emotion at play here is just “old fashioned” jealousy. We resent and object to insider trading because the majority of us are not insiders. As we have already pointed out, it is rather reminiscent of the debate on executive privileges, remuneration and perks. While this view may be thought cynical and simplistic there is a certain amount of circumstantial evidence supporting it. A surprisingly high proportion of the cases that are brought to court by the authorities in the USA are first identified, not by sophisticated stock watch programmes, but by whistle blowers. A good many of these “publicly spirited” informants turn out to be individuals who have a grudge against the person concerned or who are likely to be jealous of his or her success. In fact, it remains to be seen whether the enforcement results obtained in the USA would be sustainable without such informants. The US Congress recognising this, passed legislation in 1988 authorising the Securities and Exchange Commission to reward informants out of the sums recovered by enforcement action against insiders. A similar suggestion to pay bounties to informers in Britain, was thought in 1990 by the House of Commons Select Committee on Trade and Industry to be too avant-garde. It has been said, that a law which depends so much on such base emotions for its effective enforcement, is a law that is not worth having.

VIII. Europe's Contribution

The Council of Europe's Insider Dealing Directive⁸³ which was adopted in 1989 represents a process which can be traced back to a report of a committee of experts appointed by the European Commission in 1966.⁸⁴ During the protracted discussions that took place over the years within the Commission and its innumerable expert working groups, relatively little consideration was given to the theoretical justifications for regulating insider abuse or what devices might prove to be efficacious in controlling it. Of course, there was a considerable divergence of experience within the

83. 89/592 EEC. See J. Dine, *European Foundation*, in *THE FIDUCIARY, THE INSIDER AND THE CONFLICT* (Brehon, Sweet & Maxwell 1995).

84. See generally BARRY RIDER & H. L. FRENCH, *THE REGULATION OF INSIDER TRADING* 263 (Macmillan 1979); Barry Rider & T. M. Ashe, *The Insider Dealing Directive*, in *THE FIDUCIARY, THE INSIDER AND THE CONFLICT* (Brehon, Sweet & Maxwell 1995).

Community and 'vastly different standards in and expectations of enforcement.⁸⁵ The Directive in its Preamble, harks back to the now somewhat discredited approach of market egalitarianism encountered in the earlier stages of the development of US jurisprudence.⁸⁶ Equality is no doubt a well appreciated concept, but whether it has a meaningful role to play in the modern markets remains to be seen. While equality of opportunity, may be a goal worthy of attainment, to espouse equality of information as a regulatory concept is too idealistic. As the US Supreme Court recognised nearly twenty years ago,⁸⁷ when it doubted the simplicity of the abstain or disclose rule, the markets have moved on and today they are serviced by an industry if not profession of information gathers, sifters and assessors. An efficient and efficacious disclosure system has to take account of this. The European Directive is equally naive in espousing as a regulatory goal the somewhat continental notion of "smooth markets." Paradoxically, it was Professor Henry Manne who argued, more than most, that insider dealing smoothed-out, what would otherwise be disruptive market adjustments, by bring the price up or down to the level justified by the relevant information.⁸⁸ It has generally been assumed that even if insiders are capable of achieving such effects in the market, which is highly debatable, it is unclear why they should be allowed to derive a personal benefit. Of course, it might be said in reply that there is equally no reason why they should not expect remuneration for their "public" service, perhaps an argument not too distant from Manne's in regard to entrepreneurs. Although to some degree the Directive takes a rather different stance, to the way in which we have justified anti-insider dealing regulation in Britain and its implementation did result in significant changes in the British law, it is still perfectly possible to describe the UK law as reflecting its traditional concern to maintain public confidence in the markets.

The European Directive does underline the importance of timely disclosure of material information. While it has long been appreciated in the financial markets, that investors have a legitimate expectation of prompt disclosure of information that would effect their decisions, unless such would harm the legitimate interests of the issuer and market, the law has remained largely

85. See generally E. GILLARD (ed.), *INSIDER TRADING* (Kluwer 1992); C. RABITTI, *L'INSIDER TRADING* (Giuffrè Editore 1992).

86. See BARRY RIDER & T. M. ASHE, *INSIDER CRIME* (Jordans 1993).

87. See *Dirks v. SEC* 463 U.S. 464; *Chiarella v. United States*, 445 U.S. 222.

88. See *INSIDER TRADING AND THE STOCK MARKET* (The Free Press 1966).

uninterested. The obligation to make timely disclosure was left to The Stock Exchange and in the case of take-overs and mergers to the City Panel on Take-overs.⁸⁹ Unless disclosure would be necessary to correct an earlier representation, then there was at law no general duty on an issuer to make timely disclosure. The notion that the more such information was brought into the market, the less scope there was for insiders to take advantage of it or engage in manipulative practices, received little attention. The Stock Exchange has long placed an obligation, by virtue of the Listing Agreement, on quoted issuers to report material changes as and when they occur, in addition to the ordinary periodic disclosure of relevant information. This duty to make timely disclosure was, however, predicated on the correction or avoidance of a false market. Somewhat surprisingly, until relatively recently there was a widespread view that an ill-informed market was not a false market. The mere fact that material information was in existence, did not necessarily oblige an issuer to disclose it. If there was no evidence that it had leaked, then provided the issuer had a legitimate interest in withholding it, the information in question could be kept confidential. The combined effect of the Directive on the Coordination of Conditions for the Admission of Securities to Official Stock Exchange Listing⁹⁰ and the Insider Dealing Directive, is to impose on issuers who are listed, or have their securities traded on a recognised market an obligation to make timely disclosure. The obligation, is, however, imposed in a rather round about manner, and for listed companies remains only contractual.⁹¹ It has been argued that as in certain other jurisdictions, such as Canada,⁹² it would be sensible to impose a statutory obligation on companies to disclose price sensitive information, subject to certain caveats and protections, as and when it becomes sufficiently certain so as not to risk being misleading.⁹³

IX. Misappropriating Ideas?

It is also perhaps surprising that there has been no real

89. See generally Barry Rider, *INSIDER TRADING* 155 and Ch. 4 (Jordans 1983); Barry Rider and E. J. Hew, *The Role of the City Panel on Take-overs and Mergers in the Regulation of Insider Trading in Britain*, 20 *MAL. L.R.* 315 (1978); Barry Rider (ed.) *BRITISH FINANCIAL SERVICES REGULATION SERVICE (C.C.H.)*.

90. 79/279 E.E.C.

91. See BARRY RIDER & T. M. ASHE, *INSIDER CRIME* 10 (Jordans 1993).

92. See, e.g., Ontario Security Act § 74.

93. See, e.g., J. Spander QC, *REPORT INTO THE AFFAIRS OF COLLINS HOLDINGS LTD*, ATTORNEY GENERAL OF NEW SOUTH WALES (1978).

discussion in Britain, or for that matter elsewhere in Europe, about condemning the unauthorised use of price sensitive information on the basis that it belongs to someone else.⁹⁴ In the USA, the idea that the personal use or unauthorised disclosure of information obtained in a privileged position, is objectionable in itself, has long been relevant in fashioning the law's approach to insider dealing. In more recent times the wrong involved in misappropriating another's information and then using it for personal profit, has become the primary justification for the law's intervention.⁹⁵ This is not the place to enter upon a discussion of the so called misappropriation theory, but it is interesting, given the English law's interest in recognising and protecting confidential relationships, that such an approach has not found supporters in Britain. This may be explained by the more restrictive attitude, in Britain to what is and what is not information capable of protection through an action for breach of confidence and until very recently the English law's reluctance to contemplate a viable law of restitution. As has already been pointed out, it is conceivable that a person in a fiduciary position who misused, by use or disclosure, information that came to him by virtue of his relationship, could be held accountable.⁹⁶ The obligation, however, is owed to the person with whom he is in that confidential relationship. Consequently, such remedy as may be available, will be compensatory or possibly restitutory. At this point in time, it is hardly conceivable that the quantum jump long taken by the US courts, on the back of Rule 10B5, would be feasible for an English judge. To contend that there is a misrepresentation to the market, arising by virtue of the obligation not to abuse a private confidential relationship with someone else, would in English law be untenable.⁹⁷ It is, with respect, the intervention of Rule 10B5 with its attendant jurisprudence, which enables the US courts to convert what is at most a breach of confidence into a fraud on the market, justifying remedies and sanctions far more reminiscent of penal sanctions,

94. See Barry Rider, *Abuse of Inside Information*, 127 N.L.J. 830 (1977).

95. See *supra* note 42; *United States v. Newman*, 664 F.2d 12 (2nd Cir. 1981); *SEC v. Materia* 745 F.2d 197 (2nd Cir. 1984); *United States v. Chestman*, 947 F.2d 551 (2nd Cir. 1991); *SEC v. Libera*, 989 F.2d 596 (2nd Cir. 1993).

96. See *supra* note 13.

97. But see the author's argument in regard to the former Section 13 of the Prevention of Fraud (Investments) Act 1958, available in Barry Rider, *The Crime of Insider Trading*, 19 J.B.L. (1978); see in regard to a similar argument under Israeli law, A. YORAN, *INSIDER TRADING IN ISRAEL AND ENGLAND* 59 (The Institute for Legislative Research and Comparative Law of the Hebrew University 1972).

than the usual devices of the civil law. Although the present author has in the past argued that the British equivalent to Rule 10B5, could be stretched to cases of insider abuse, and recent legislative proposals would more or less accomplish this, the vitality of the English law in this regard is but a shallow reflection of its American cousin. Before leaving the misappropriation theory, however, it should be noted that the British law in its statutory offences, insofar as insider status and inside information are tied to relationships which may be expected to afford privileged access to inside information, inevitably recognises, albeit in a very attenuated and often weak form, a notion of confidentiality. This was more explicit in the pre-1993 law, but is still discernible even in the far more open textured provisions imported from the Directive.

X. Scandals—the Engine of Reform

The history of financial services regulation in Britain records that, in the main, reform is scandal driven.⁹⁸ This is also the case in many other jurisdictions. Almost every significant reform of the law or its administration in Britain has occurred as a direct result of the concern felt after a major scandal which has either dramatically illustrated the incompetence of the existing law or a significant lacuna in regulation.⁹⁹ Sadly this has meant that experimentation and refinement of the law and regulatory devices has been pragmatic and has generally only been viable when it can be conveniently attached to the coat tails of some measure that is justified by public outrage. Perhaps one of the best, and yet saddest examples of this, albeit taken from the USA, is the American Law Institute's Draft Federal Securities Code. Despite years of work by some of the most eminent securities lawyers in the world, led by Professor Louis Loss, the Code has had surprising little effect in the USA.¹⁰⁰ One of the few countries where it has been taken seriously and enacted in part is Pakistan,¹⁰¹ a country that hardly has a

98. See generally G. Gilligan, *The Origins of UK Financial Services Regulation*, 18 CO. LAW 167 (1997); G. Gilligan, *The Michael Lawrence Sacking—A Confirmation of the Regulatory Traditions of the Stock Exchange and City of London*, 4 J.F.C. 207 (1997); Barry Rider (ed.) BRITISH FINANCIAL REGULATION SERVICE (C.C.H.)

99. A very significant exception to this is the present major programme for company law reform in Britain initiated by the Department of Trade and Industry. See MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY, THE STRATEGIC FRAMEWORK (D.T.I. 1999).

100. See generally L. LOSS, THE FUNDAMENTALS OF SECURITIES REGULATION (Little Brown 1996).

101. See generally Barry Rider, *Blindman's Bluff—A Model for Securities*

financial services industry. On the other hand, there are those who point out that financial services regulation is not an end in itself. It is there to facilitate the efficient, orderly and perhaps even fair operation of the markets as allocators of scarce resources. True, it is also there to reflect and where necessary protect other public interests, such as the maintenance and advancement of probity, competence and where appropriate stewardship. Consequently, given its finite role, it is only necessary and perhaps even desirable that legislators and regulators do only find the time to intervene once a significant deficiency has been clearly identified. If something is not broke why mend it? This somewhat minimalist approach, while no doubt reflecting a certain amount of reality, does not take account of changing attitudes and the development and refinement of standards in the market and industry. It is no doubt the case that the trend to focus more on requiring those who manage other peoples' money to conform to certain objective criteria of competence and financial soundness may in large measure be a response to the inability of the criminal law to deal with blatant fraud and abuse, with the consequence that we have effectively lowered the threshold of liability or at least activated prudential surveillance at a lower level than sin, but there is also a real change in attitude. It is now no longer appropriate for regulators, or even governments, to confine their activities to the prevention and control of fraud. It is in everyone's interest that investment decisions are taken sensibly, with the support of competent and well informed professional advice. The knee-jerk approach to legislation also does not address the need for regulatory systems to take account of fundamental developments in the markets or the development of external, but intrusive standards. For example, in Britain the law is subject not only to influence from Brussels, but also must take account of the global market.

It is perhaps surprising that the perceived ability of a regulatory system to deal with insider abuse has played such a significant role in assessing the general efficiency and efficacy of the system as a whole. We have already seen the way in which the debate on insider dealing coloured and, indeed, drove discussion as to the shape and content of securities regulation in Britain. But this is equally the case in many other jurisdictions, ranging from Australia to the Netherlands. While this may be allowing the "tail

to wag the dog.” it is perhaps understandable in political terms. Insider abuse is in its most simplistic form well understood by the media and public. It is depreciated because it illustrates all the wrongs of privilege and elitism and can therefore be easily isolated and sensationalised. Whether the ability of a regulatory system to address, other than in purely cosmetic or public relations terms, this problem, matters a great deal to the market, remains, in the view of the present author, a matter for debate. Indeed, it was not that long ago that at a meeting of representatives of senior regulators from around the world, one very senior representative of an important securities exchange, stated that if we accept that drawing attention to insider abuse adversely effected confidence in the market, or at least unnerved politicians, then perhaps the best solution was not to bother looking for it. He added that in his experience, there were few instances, anywhere in the world, where after insider abuse had been identified and brought to the public’s attention, the public were suitably impressed by the results of regulatory or legal action. Indeed, in his view it was sensible, as his market operated in a jurisdiction where insider abuse was taken “seriously,” to slow down and even delay the proceedings so that by the time a sanction or punishment was imposed, or in the case of his jurisdiction “agreed” the press and public would have lost interest in the specific case. Consequently, it was the most dedicated and efficient regulators who really got their hands burnt by insider dealing. The motto of all good market regulators, in his view, should be that of the proverbial three wise monkeys, “see no evil, hear no evil, speak no evil.” Although this gentleman did not receive a standing ovation, there was widespread agreement, and in time he went on to join in a very senior position his own country’s statutory regulatory authority!

It cannot therefore be assumed that even within the agencies and organisations charged with policing insider abuse, or at least identifying it, that there is always great dedication and determination to take action and be exposed. Little work has hitherto taken place by criminologists or other social scientists on the enforcement culture within non-police agencies such as regulatory commissions and self-regulatory bodies. We are told, that in the case of police agencies, officers do not like being assigned the investigation of fraud and economic crime cases because they are not sufficiently macho. The investigatory process is time consuming, complex, boring and rarely leads to any drama. Arrests are few and convictions even fewer. In other words, this type of police work is not for those who are ambitious or who like

excitement. Of course, things have changed a little with the recognition of the importance of financial based intelligence and the realisation that organised crime is really nothing more, in many cases, than a business. In the result, ambitious policemen will be prepared to “put their time in” to fraud work, but only as a means to an end. Indeed, because of the inability of conventional police agencies to get satisfactory results in cases of economic crime, in many countries responsibility for the investigation of specific areas of abuse, such as that involving the financial markets, has been taken out of traditional law enforcement and entrusted to either special agencies or effectively franchised to private, in some cases commercial, bodies. It is beyond the scope of this paper to raise, let alone discuss, all the issues of accountability, human rights and competence—legal and otherwise, that arise in such circumstances. Nor is it feasible to address the myriad of problems, that can and do arise in parallel proceedings. That is to say where proceedings are initiated at different levels within the legal system on the same evidence and involving the same parties. In such cases there are profound issues as to evidence, the standard of proof and the compatibility and management of proceedings. Obviously, the proliferation of authorities charged with different responsibilities increases the risk of multiple proceedings. In cases of insider dealing it is conceivable that there might be concurrently a criminal prosecution, civil enforcement proceedings, civil litigation for compensation or restitution, disciplinary proceedings, collateral actions against those involved as secondary offenders or as professional facilitators, as well as the real possibility of proceedings overseas.¹⁰²

Many of those who work in regulatory authorities, with special responsibility for the investigation, and even in some countries the prosecution, of abuse in a particular environment, may well be at variance with the attitude and culture encountered in ordinary police agencies. They will often be disassociated from conventional law enforcement, but will wish to be identified with and will invariably be drawn into what they perceive to be a pseudo-police culture. The problem is that their authority is limited, indeed, it may even be questioned, if not resented by police and other law enforcement agencies. They will not, unless they are retired police officers, have personal or professional credibility with other law enforcement agents and they will not have the moral and political

102. See M. Andenas, *Enforcement of Financial Market Regulation—Problems of Parallel Proceedings*, C.E.L. KING'S COLLEGE, Working Paper 1/95 (1995).

authority of being a member of a large, highly visible and structured agency. This will inevitably impact on their own self-confidence and attitudes to other agencies. There will be no real career path and little opportunity for diversification. Lawyers and accountants who are recruited for such posts, without the benefit of relevant training, may well be tempted to assume the guise of inquisitors rather than investigators, and attempt to make up for in image what they lack in experience. Recent history has shown, that in these agencies, those charged with the enforcement function often have inadequate knowledge in regard to the taking, maintenance and presentation of evidence and very little regard for the rights of suspects. It would be unfair and unjustified to suggest that all such regulatory authorities have been unable to address these problems. There are many agencies, particularly in North America, where the competence and training of such officers is second to none. However, it must be recognised that in any authority that has a limited mandate the criteria for success or failure are rather more focussed and therefore the implications, both institutionally and personally, in pursuing matters which lead to disappointment or embarrassment are so much greater.

It was partly as a result of the frustration felt by the highly competent staff within the US Securities and Exchange Commission, with the way in which District Attorneys in the Justice Department were reviewing and proceeding with their cases, that they developed a viable civil enforcement jurisdiction for the Commission, over which they retained control. Given the identification of individual members of staff with the special enforcement mandate of the agency, where individual officers are ambitious, there is a great danger for rules to be broken and for abuse to ensue. It is not without interest that special investigatory and prosecutorial agencies set up to spearhead enforcement in areas such as financial and commercial crime, have themselves experienced a disturbing high level of corruption. In looking at the way in which the law is administered and applied in cases of insider abuse, it is very dangerous to ignore the institutional imperatives which operate within those organisations charged with policing the law.

Those charged with policing the relevant law in Britain have found insider dealing something of a "hot potato."¹⁰³ The

103. See Barry Rider, *Policing Insider Dealing in Britain*, in EUROPEAN INSIDER DEALING, (Butterworths 1991); Barry Rider, *Civilising the Law—the Use of Civil Proceedings to Enforce Financial Services Law in the United Kingdom*,

Department of Trade and Industry has not distinguished itself over the years as a particularly competent enforcer of either corporate law or financial services law. While it was given powers to appoint inspectors to conduct investigations into suspected cases of insider dealing, by the Financial Services Act 1986, its role in policing insider abuse has been diffident. The Serious Fraud Office established in 1987 as a direct result of the Roskill Committee on Fraud Trials has been reluctant to get involved in policing insider dealing. Indeed, initially the view was taken that ordinary cases of insider abuse would not come within its statutory mandate of serious or complex fraud. Insider dealing was rather more a technical or regulatory offence. This view has changed, but nonetheless the SFO has not been eager to bring cases. Consequently, the majority of prosecutions have been left in the hands of the police, occasionally assisted by officials and inspectors from the Department of Trade and Industry, with the prosecution being brought by the Crown Prosecution Service. It is possible for the Secretary of State for Trade or the Director of Public Prosecutions to designate another authority to prosecute and on one or two occasions The Stock Exchange has been authorised to proceed. The Securities and Investments Board was not given authority to prosecute cases of insider dealing, although it did enjoy certain civil enforcement powers in regard to breaches of its own rules.¹⁰⁴ The relevant rules address insider dealing by authorised persons and their executing transactions for clients in circumstances where they know or suspect that they might be in violation of the statutory prohibitions on insider dealing. Although at least one Chairman of SIB thought that its powers to enjoin violations of its rules and seek restitution orders could therefore be used in cases of insider abuse, the SIB never chanced its hand in such a case. By the same token the various self-regulatory authorities whilst prepared to contemplate disciplinary action on the back of a prosecution, showed considerable reluctance to take the initiative.

XI. A New Beginning

The Labour Government, having expressed profound concern as to the seeming inability of the regulatory system to adequately discourage and then deal with abuses when they occurred, announced in May 1998, with surprisingly little consultation, a

CORPORATE AND COMMERCIAL LAW (Lloyds of London Press 1996).

104. See C. Currie, *The Civil Law as a Means of Exploring Securities Law*, in DEVELOPMENTS IN EUROPEAN COMPANY LAW (Kluwer 1996).

fundamental shake-up. The SIB was renamed the Financial Services Authority and the Bank of England's role as supervisory authority over banks and deposit-taking institutions was transferred to it. The functions and responsibilities of the three remaining self-regulatory organisations were merged into the Authority and its remit extended to all financial products.¹⁰⁵ The FSA as a super, essentially onestop, financial regulator will be given over the course of the next year or so authority to prosecute not only offences under the Financial Services Act 1986, but also insider dealing and certain offences under the Money Laundering Regulations, as we have already seen. The new Draft Financial Services and Markets Bill,¹⁰⁶ when it becomes law, will not only furnish the FSA with the requisite statutory authority, but also provide it with a new and imaginative array of weapons. Apart from its disciplinary jurisdiction, which will be statute based, rather than as hitherto based on contract law, it will be armed with wide ranging civil enforcement powers which go some way beyond those in sections 6 and 61 of the 1986 Act. It will be able to seek prohibitive and remedial injunctions together with freezing orders from the Court. It will also be able to seek, or order itself, restitution. Furthermore, for breaches of its rules it will be able to impose fines itself. In addition, to these powers the FSA will retain the investigatory powers now contained in the 1986 Act, but amended so as to make it clear that evidence obtained pursuant to their exercise can be utilised in subsequent prosecutions. There can be no doubt that the Government is able and willing to empower the FSA to assume the primary enforcement role in regard to financial misconduct and related activity. Of course, it remains to be seen whether the institutional and other constraints, to which reference has already been made will serve to undermine the enthusiasm that has so far been evident within the newly constituted Authority. There is widespread concern about the impact of the human rights legislation on both the FSA's enforcement powers and in particular its powers to sanction misconduct.

In the context of insider dealing, however, the most significant proposal is the enactment of a new offence—that of market abuse.

105. See Barry Rider, C. Abrams & T. M. Ashe, *GUIDE TO FINANCIAL REGULATION* Chs. 1 & 2 (3rd Ed. CCH 1998); R. Sarker, *Reform of the Financial Regulatory System*, 11 CO. LAW 19 (1998). For background, see G. Gilligan, *The City of London, The Financial Centre of Europe—A Case Study in Regulation*, in *DEVELOPMENTS IN EUROPEAN COMPANY LAW* (Kluwer 1996).

106. July 1998, Treasury. See A. Alcock, *The Draft Financial Services and Markets Bill*, 19 CO. LAW 258 (1998).

The Government in the Consultation Document,¹⁰⁷ which accompanies the Draft Bill, emphasises that market abuse can take a number of forms including the misuse of inside information. It makes it clear that the abuse of inside information is damaging not only to the markets, but to the economy as a whole, increasing the cost of raising capital. The Draft Bill, itself underlines the importance of promoting and maintaining confidence in the markets, by placing this at the top of the list, of statutory objectives for the FSA. The new offence,¹⁰⁸ which will need a considerable amount of reshaping and drafting before enactment, provides that market abuse is behaviour, which is defined as doing something or not doing something, which occurs in relation to certain investments traded on a market, which satisfies one or more of three conditions. The first is that the behaviour is based on information which is unavailable to informed participants in the market who are unaware of the behaviour but which, if available to such informed participants, would be likely to be regarded by them as relevant in deciding whether or not to enter into transactions involving investment of that kind. The other two conditions, are rather more concerned with manipulative conduct and relate to behaviour which creates a mistaken impression as to the state of the market or circumstances of a particular investment, or is likely to distort the market. Finally, for the offence to be committed the behaviour in question must be likely, or if the circumstances were publicly known or the behaviour became common place, or both, would be likely, to damage confidence of such informed participants that the market, so far as it relates to investments of that kind, is a true and fair market. It should be noted that the statutory wording does not require any intention on the part of those engaged in the behaviour and most of the standards are objective. The behaviour must occur in, or be in regard to an investment, which is traded on a market in the UK.

Recognising the importance of secondary and derivative trading, particularly in the context of insider abuse and market manipulation, the Draft Bill provides that behaviour will be considered to have occurred in regard to an investment, if it occurs in relation to anything which is the subject matter of the relevant investment, or if it occurs in relation to investments whose subject matter is the relevant investment. It is also made clear that in the

107. FINANCIAL SERVICES AND MARKETS BILL: A CONSULTATION DOCUMENT Part I Ch. 15 (Treasury July 1998).

108. Clause 56.

case of market manipulation, it matters not whether the outcome which is expressed as likely to occur, actually occurs or not.

The Draft Bill provides in clause 57, that the FSA must prepare a code for the purpose of helping to determine whether or not behaviour amounts to market abuse. The code should not only be descriptive but also enumerate factors which, in the opinion of the Authority, should be taken into account in determining whether or not behaviour amounts to market abuse. Furthermore, perhaps even more curiously worded, is a provision which states that the Code may be relied upon so far as it tends to establish whether or not the behaviour in question amounts to market abuse.

The FSA has published a consultative document¹⁰⁹ and a draft code in which it attempts to flesh out this rather strange provision. In the code it is stated that information for the purposes of the code and therefore, the offence, is information which persons using the market would reasonably regard as significant in determining whether to deal in an investment traded on that market. Thus, relevant information may include information concerning the business affairs or prospects of the issuer or a related company, or the occurrence, or likely occurrence, of events which might affect those affairs or prospects. The substantive provision in Clause 56(6) of the Bill also provides that information will not be considered to be unavailable to informed participants in the market if the information could be obtained by research or analysis on behalf of such persons. The Code provides that disclosable information is information which is required to be disseminated, either immediately or in time, on or in relation to a market. This would include information that is subject to timely or periodic disclosure obligation whether imposed by law or presumably contract. The law relating to insider dealing contained in the 1993 Act will remain in place untouched by the provisions of the Bill or the Code. Although the provisions in the Code do not comport entirely with the definitions found in the 1993 Act they in all probability amount to much the same.

The Code, in describing behaviour which may amount to market abuse, refers to the unfair use of relevant information. It provides that a person who has privileged possession of relevant information that is disclosable information should not deal in any investment to which the information is relevant, if market users would reasonably regard the information as significant in

109. MARKET ABUSE, CONSULTATION AND DRAFT CODE OF MARKET CONDUCT (F.S.A. June 1998).

determining whether to deal in that investment. Relevance of the information is therefore tied to materiality. A person, according to the Code will be in privileged possession of information for so long as he knows or ought to know that other market users cannot legitimately obtain that information. The Code adds that commonly a person will have privileged possession because of a special relationship the person has with the source, or because he has obtained the information by reason of a disclosure that ought not to have been made or was made mistakenly. It should be noted that whether a person ought to know is to be judged against the general knowledge, skill and experience expected of a person in his office, employment or position. In other words, the test is objective. Where a person has privileged possession of relevant information that is also disclosable information, the Code makes it clear that he should not do any act, nor engage in any course of conduct, which might reasonably be considered as likely to encourage or induce any other person to deal in investments to which the information is relevant. Whether a person's actions might reasonably be considered likely to encourage or induce others to deal must be considered in the light of all the circumstances, including accepted market practices and the expertise of the persons concerned. The Code states that disclosing the relevant information to another person will commonly constitute encouragement. This is doubtful and goes considerably further than the statutory provisions rendering encouragement of another to deal on the basis of inside information an offence.

It is in the context of take-overs and mergers that it is thought, at least in Britain, most insider dealing occurs. While there is evidence that abuse of privileged information does occur in such circumstances there is little convincing evidence that this is more than in other situations. Nonetheless, insider dealing at the time of take-overs and mergers has always attracted special attention. The Code provides that where a person proposes to mount a take-over bid in relation to a company the information about his proposals is treated as relevant information and is disclosable information. Consequently, any person in privileged possession of such information may not use the information unless he is the offeror or is acting for the offer. This does not add to the existing law, or for that matter the provisions of the City Code on Take-overs and Mergers. It is also provided, that an offer or person acting on behalf of the offer may use the information only for the purposes of pursuing the bid. The Code also encompasses the misuse of market information, which it describes as "order-flow information."

Information concerning a person's intention to deal in investments, or information as to trades that have taken place may constitute relevant information, depending upon its significance. This is in line with the existing law.

Finally, the Code provides that a person may deal in investments while in privileged possession of relevant information that is disclosable information if he can demonstrate that the information did not in any way influence him in determining whether to deal. A very onerous obligation!

Perhaps the most significant aspect to the new offence of market abuse, is that it will not attract criminal liability. It is a civil offence, which gives rise to a civil fine. The Draft Bill will empower the FSA to impose fines itself or apply to the court for the imposition of a fine. Furthermore, the Authority will also be able to seek injunctions and orders from the Court specifically in regard to cases of market abuse and may seek, or itself impose an order for restitution.¹¹⁰ While at this stage it is not entirely clear whether the existing provisions enabling private investors to sue for a statutory tort in the event of breaches of certain provisions and rules, will extend to the market abuse offence, it is thought that provision will be made for such suits. It is important to appreciate that this new regime will operate along side the existing law relating to insider dealing and, of course, the relevant provisions in the City Code on Take-overs and Mergers and in the Listing Agreement.

XII. Chinese Walls and Other Puzzles

Another issue that has arisen and will be addressed by the new legislation, either directly or through the FSA's rule making powers, is the position of multiple function fiduciaries. It has long been recognised that where a financial intermediary is engaged in, for example, investment advisory and corporate finance work, or acts for a number of clients—with possibly competing interests, a strict application of the fiduciary law in regard to the avoidance and control of conflicts of interest might cause serious difficulties for all concerned and not least the intermediary.¹¹¹ It is conceivable that

110. The author has long advocated this approach, *see, e.g.*, Barry Rider, *The Day of the Civil Sanction?*, 17 CO. LAW 257 (1996); Barry Rider, *See No Evil*, 18 CO. LAW (1997); Barry Rider, *Getting Tough with the Market*, 19 CO. LAW 289 (1998). Indeed, he expressed the view in July 1975 that the then proposals for regulating insider abuse would not work without new and radical enforcement procedures. *See* Barry Rider, *One Aspect of the Unacceptable Face of Capitalism: The Crime of Being Something Big in the City*, 9 OBITER 11 (1975).

111. *See* Barry Rider, *The Fiduciary and the Frying Pan*, THE CONVEYANCER

an investment client might complain where information within the intermediary, obtained by virtue of another relationship, has not been utilised by the intermediary to maximise his profits or, perhaps more seriously avoid a loss. Indeed, even if a claim based on the fiduciary relationship was thought, for one reason or another, to be untenable, then it may well be that there is a viable claim in the tort of negligence, or even in a limited number of cases, contract. There is also the problem of confidential information. To what extent can one client protect information that is attributable to the relationship that he has with the intermediary, from use by the intermediary for the benefit of others with whom it is also in a fiduciary relationship. If the information in question constituted inside information, the intermediary might well find itself in difficulty under the criminal law. It has been said, that the civil law could not condemn an intermediary for failing to use information which would amount to a criminal offence. Indeed, one minister said it was nonsense to assert that a fiduciary could be impeached for failing to rob a bank for his beneficiary. This rather misses the point. The fact is that the criminal law is not wide enough to encompass every situation in which there may be a real prospect of civil liability. Furthermore, this does not address, for example the problem of liability in negligence or the ability of a client to protect the risk of misuse of information otherwise by trading in investments. In Britain, as in most countries,¹¹² the expedient of a "Chinese Wall" has been employed to segregate both information and functions within the intermediary which might be considered to involve competing obligations. The problem with such a device is that it might prevent the flow of information but it does not address the fundamental conflict of interest and duty. The courts have been reluctant to accept that the segregation, within a single entity, can resolve the issue of conflict. Furthermore, in a recent decision by the House of Lords,¹¹³ it was held that such internal arrangements can only serve as a defence to allegations of misuse of confidential information, if they are built within the very institutional structure of the business and remain intact. Indeed, in another recent

114 (1978); Barry Rider, *Conflicts of Interest and Chinese Walls*, THE REGULATION OF THE BRITISH SECURITIES INDUSTRY (Oyez 1979).

112. See generally C. NAKAJIMA, *CONFLICTS OF INTEREST AND DUTY* (Kluwer 1999); H. MCVEA, *FINANCIAL CONGLOMERATES AND THE CHINESE WALL* (Oxford University Press 1992). See also H. McVea, *Regulatory Rules and the Common Law: the Impact of the Chinese Wall on Liability for Deceit and in Contract*, 17 CO. LAW 290 (1996); G. McCormack, *Conflicts of Interest and the Investment Management Function*, 2 CO. LAW 20 (1999).

113. *Bolkiah v. KPMG*, 1 All E.R. 517 (1999).

decision, the House of Lords¹¹⁴ emphasised that it must be remembered that the adequacy of compliance arrangements only went to the issue of mitigation. If what is forbidden has in fact occurred then liability will follow as day follows night. The Law Commission examined,¹¹⁵ among other things, the viability of Chinese Walls and while noting that the courts now accepted that contractual delimitation of duties and expectations was possible, and the otherwise strict responsibilities of a fiduciary might be varied or mitigated through informed assent, there remained a real problem. The Law Commission proposed specific legislation to address the problem. The Government has indicated, in its Consultative Document, that the Bill will ensure that compliance with the FSA's rules relating to Chinese Walls which manage or avoid conflicts of interest and help prevent insider dealing will protect a firm not only against criminal liability for insider dealing, but also against a civil action for breach of duty. This is welcome.

An area of the law that is not addressed, however, in any of the Government's documents or those put out by the FSA is that of attribution of knowledge. Obviously, although this is a particularly important issue, not least in the context of insider dealing, it is beyond the scope of this paper. Nonetheless, it would be remiss not to allude, at least *en passant*, to a line of recent cases in the English courts which have altered the law of attribution and carried it to a point that many might consider too far. The impact of these developments on financial services law has received little attention by the commentators, and yet the implications may be profound. In *Re Supply of Ready Mixed Concrete (No 2)*,¹¹⁶ the court was faced with a situation, where to impose liability for breaching an order outlawing a restrictive trade practice, it had to find that two companies had entered into an arrangement, notwithstanding that those who had been responsible for their company's operations had been expressly instructed not to enter into any such arrangements and had no semblance of authority to do so. In such circumstances, the ordinary rules of attribution, let alone agency and vicarious responsibility were useless. Lord Templeman stated that there were areas of the law in which the public interest justified a robust approach to such issues. He considered that "an employee who acts

114. *Re Supply of Ready Mixed Concrete (No 2)*, I.A.C. 456 (1995).

115. FIDUCIARY DUTIES AND REGULATORY RULES, CONSULTATION PAPER NO 124 (H.M.S.O. 1992); FIDUCIARY DUTIES AND REGULATORY RULES, REPORT NO 236 (H.M.S.O. 1995).

116. *See Re Supply of Ready Mixed Concrete*, *supra note* 114; C. NAKAJIMA, CONFLICTS OF INTEREST AND DUTY (Kluwer 1999).

for the company within the scope of his employment is the company.” He added, “directors may give instructions, top management may exhort, middle management may question and workers may listen attentively . . .” but at the end of the day if what is done is done by that employee within the scope of his employment, he is the company. In such situations we are not talking so much about attribution of knowledge or responsibility, but merger of the individual with his organisation. This extreme approach, no doubt justified on the facts, has been followed in decisions pertaining to the reporting of aggregated interests in shares and even fraud.¹¹⁷ The impact of this new doctrine on the financial services industry may well be significant, and it is unfortunate that it has not so far been addressed by the FSA.

XIII. A Pragmatic End!

In his paper the author has attempted, in a rather egocentric and therefore rambling manner, to conduct the reader through the issues, as he sees them relating to the effective control of insider dealing, albeit in the main from the perspective of an English lawyer. There are, of course, many other matters worthy of discussion, but a line needs to be drawn somewhere. Consequently, the author has not made any attempt to enter into a detailed discussion of the framing or for that matter purport of the British legislation. Such analysis is available elsewhere.¹¹⁸ What he has tried to bring out is, the pragmatic way in which the law has been developed and administered in Britain and the institutional considerations which effect enforcement. As the author indicated, at the start of this paper, there was a time when he considered insider abuse one of the most egregious crimes, but with the benefit of mature reflection, and the cynicism that comes with having himself served for nearly a decade as an investigator in an agency concerned with serious economic crime, his views are today less certain. Of course, matters that are of concern to society must be of concern to those who govern society and are charged with protecting the public interest. However, there is an issue of balance, and there may be issues which require rather more

117. *Meridian Global Funds Management Asia Ltd. v. Securities Commission*, 2 A.C. 400 (1995). See also S. Robert-Tissot, *A Fresh Insight into the Corporate Criminal Mind*, 17 CO. LAW 99 (1996).

118. See generally BARRY RIDER & T. M. ASHE, *INSIDER CRIME* (Jordans 1993); T. M. ASHE & L. COUNSELL, *INSIDER TRADING*, (2nd Ed. Tolley 1993); B. HANNIGAN, *INSIDER DEALING* (2nd Ed. Longman 1994); GORE BROWNE ON COMPANIES (Jordans).

attention than insider trading. Insider trading is not the most heinous crime of the late twentieth century,¹¹⁹ although future historians who look back at our newspapers might be forgiven for thinking it was. We have accepted the expedient of criminal legislation, without proper regard to the efficacy of such laws and the impact that they might have on, for example, the civil and commercial law. Insider dealing and financial misconduct does not occur in a vacuum. We have paid perhaps too little attention to ethical training and prevention. We have also tended to ignore the institutional issues within enforcement. In this context we have not even started to address the implications of electronic trading in a global environment. What is certain is that concern about insider abuse will not go away, it relates to something very fundamental—human greed, and we can be morally certain that while we are still on this planet we will always have insiders taking advantage, fairly or otherwise, of the rest of us.

119. See BARRY RIDER (ed.) *CORRUPTION: THE ENEMY WITHIN* (Kluwer 1997); Barry Rider, *Insider Trading—a Crime of Our Times*, in *CURRENT DEVELOPMENTS IN BANKING AND FINANCE LAW, CURRENT LEGAL PROBLEMS* (Sweet & Maxwell 1989).

