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UK: Recent News

1. Court of Appeal upholds sentence for insider dealing: 10 June 2009

The Court of Appeal has upheld the eight-month custodial sentence imposed upon Christopher McQuoid, following his conviction in March for insider dealing. Mr McQuoid, a solicitor, was the first individual to be successfully prosecuted by the FSA for criminal insider dealing. He had argued that his sentence should be reduced because he was unlucky enough to be caught at a time when the FSA had switched from pursuing regulatory action to bringing criminal proceedings against those charged with insider dealing. Had he been convicted earlier, he maintained, he would only have incurred a fine.

Perhaps unsurprisingly, the Lord Chief Justice gave short shrift to this argument. In so doing, he suggested that criminal, rather than regulatory, action is the more appropriate in cases of insider dealing, which he characterised as a type of fraud. The judge argued that insider dealing represents a breach of the trust placed in insiders that undermines public confidence in commercial markets. This decision makes it clear that the courts do not consider insider dealing to be a victimless crime. Nor will the previous good character of an accused operate as a mitigation of his or her wrongful actions; the very act of insider dealing is likely to be sufficient to impugn this.

The Lord Chief Justice went on to list the factors which may increase or decrease the sentence given to those convicted of insider dealing, noting that an offence committed jointly by more than one person trusted with confidential information would be more damaging to public confidence than an offence committed by an individual alone. The maximum prison sentence is currently seven years.

The decision is certain to be welcomed by the FSA and may help to vindicate its much-publicised moves to take a tougher stance against insider dealing by pursuing criminal prosecutions. The comparative simplicity and the overwhelming evidence of guilt in this case are not representative of the challenges that the FSA faces in bringing successful prosecutions for insider dealing, which has a higher burden of proof than a civil action for market abuse. In particular, the need to prove knowledge on the part of the accused that the information in question was "inside" information, places an onerous burden upon prosecutors. Whilst it might seem strange that a body charged with preventing financial crime has not, to date, brought a significant number of criminal prosecutions, it may well be that in a number of cases a civil action for market abuse is all that can be reasonably sustained.

Thus, despite the FSA's success in the McQuoid case, the jury is still out as regards the credibility of this vaunted initiative. Other insider dealing cases coming to trial later in the year, including the case outlined in the next article, are understood to be more factually and legally complex. These should serve

as more accurate indicators of the FSA's emerging record in this challenging area.

2. City lawyers appear in court on insider dealing charges: 16 June 2009

Further to our report last month, city lawyers Andrew Rimmington and Michael McFall recently appeared at the City of Westminster Magistrates' Court charged with eight counts of insider dealing contrary to s.52 Criminal Justice Act 1993. They were joined by the former finance director of NeuTec Pharma, whose takeover by Novartis in 2006 is at the centre of the events which give rise to the prosecution. All three were granted unconditional bail. Proceedings have now been adjourned to 28 July 2009, when Magistrates will consider committal to the Crown Court for trial.

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UK: Recent Decisions

3. Trader banned for "pre-hedging" without customers' consent: 26 May 2009

Nilesh Shroff, a former executive director of risk-trading at Morgan Stanley, has been fined £140,000 and banned from performing any regulated function for deliberately "pre-hedging" trades, without his customer's consent. On seven occasions between June and October 2007, Mr Shroff partially pre-hedged programme trades to the disadvantage of Morgan Stanley clients. The FSA found that this was done deliberately, in the full knowledge that pre-hedging was expressly prohibited by both Morgan Stanley's policies and the FSA's Principles for Business, and that it was not in his clients' best interests. According to the FSA, Mr Shroff's culpability was exacerbated by the fact that he was a senior trader in a position of responsibility and that his misconduct had been repeated on half a dozen occasions.

Mr Shroff's actions caused Morgan Stanley to breach Principle 6 (Treating Customers Fairly). He was dismissed by the firm for gross misconduct in December 2007, with his pay for that year significantly reduced. Neither Morgan Stanley, nor any companies related to it, were criticised by the FSA in respect of this decision. Margaret Cole, FSA Director of Enforcement, indicated that Mr Shroff had "repeatedly abused his position of responsibility as a senior trader and the trust placed in him by clients and his employer". She went on to emphasise that the FSA will prosecute those who act "without honesty or integrity" and in contravention of FSA rules.

For a link to the full decision on the FSA website, please click here **...**

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UK: Policy and Practice

4. FSA intensifies efforts to tackle insider trading: 1 June 2009

The FSA is understood to be bolstering its enforcement division by hiring several lawyers from leading City firms, as part of its plans to step up the FSA's fight against insider dealing.

The new recruits will raise the number of enforcement staff to about 340, 80 of whom will be dedicated to investigating wholesale cases that involve financial institutions and their employees. The news follows the move earlier this year by prominent senior criminal prosecutor David Kirk to the FSA from the Crown Prosecution Service (see further the 25 March 2009 edition of this Update).

The FSA's enforcement division has been increasingly active over the last 12 months, winning its first two criminal convictions for insider dealing and securing its first custodial sentence (see further item 1 above). In late May, a further six people were arrested in raids at eight properties in connection with a suspected organised insider-dealing ring. Margaret Cole, the FSA's director of enforcement, has also indicated that the regulator is likely to bring three more criminal insider dealing prosecutions before the end of 2009.

The FSA has been criticised in recent months for focussing its efforts upon apparently "easy targets", rather than addressing larger-scale or persistent offenders. Ms Cole has commented that market abuse at large City institutions would not be overlooked, although the closest the FSA has come to this so far are the prosecutions against two City lawyers and a finance director in connection with the takeover of NeuTec Pharma in 2006 (see further item 2 above).

5. FSA publishes annual report for 2008/09: 24 June 2009

The FSA's annual report for 2008/09 sets out some interesting statistics concerning enforcement that

highlight the increased activity in this division of the FSA. The report indicates that 302 investigations were closed in the last year, resulting in 371 outcomes. Of these, 243 concluded with the use of powers, with a further 30 culminating in private warnings. Strikingly, the FSA levied a total of £27.3m in fines, compared to £4.4m the previous year. In particular, penalties totalling £675,000 were imposed on eight individuals and one firm for market abuse.

Given the time taken to progress investigations, the majority of the fines imposed in 2008-9 are likely to have related to activities that took place before the current financial crisis. it is, therefore, possible that there will be further increases in future years as the impact of enforcement in relation to market activity during the credit crunch is felt.

For a link to the full report from the FSA website, please click here **...**

The FSA has also recently announced that it will publish a consultation paper in early July on the proposed changes to its financial penalties policy. This is likely to herald a substantial increase in the level of fines being imposed by the FSA, to a level which it considers likely to achieve "credible deterrence" of wrongdoing.

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Japan: Recent News

6. The Tokyo District Court finds mis-selling of a derivative product to experienced investors

The Tokyo District Court has ordered Merrill Lynch Japan Securities ("**MLJS**") to pay damages for mis-selling a bespoke interest rate swap to experienced investors. The court decided that securities firms are responsible for supplying relatively detailed forecasts and projections which must be reasonable and supported by historical trends. Despite the fact that the investors had considerable experience of other derivative products, the firm was held liable for damages because such information had not been supplied to the investors.

This is a rare example of the Tokyo court finding that a financial product was mis-sold to sophisticated investors. The investors were institutional, albeit not professional market participants. They had had considerable experience in products such as structured notes and knock-in/knock-off options. The Special Transaction Review Committee within MLJS had approved the interest rate swap on condition that the "(interest rate) sensitivity analysis" was delivered to the investors. To some extent the case turns on these facts - but it is likely that the court's attribution of responsibility to MJLS in these circumstances may have a significant impact on the way in which securities firms in Japan approach their dealings with sophisticated investors.

7. The Financial Services Agency of Japan ("FSAJ") suspends the retail banking operations of Citibank Japan

The FSAJ has suspended all sales operations pertaining to all products handled by the retail banking division of Citibank Japan. The FSAJ cited inadequacies with the firm's compliance system, particularly with regards to complying with the requirement to notify suspicious transactions such as money laundering transactions. The FSAJ also found that a previous regulatory business improvement order, issued in September 2004, had not been complied with by the bank.

The FSAJ accused the bank's management committee of lacking understanding of Japanese regulations and awareness of the necessity to improve, and of failing to have a structure to discuss and address important management matters The bank was therefore found to lack control over certain business departments. The internal audit department was also alleged to have failed to identify such issues.

For a link to the FSAJ announcement in English, please click here **...**

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US: Recent News

8. Obama proposes massive overhaul of U.S. financial regulatory system: 17 June 2009

On 17 June 2009, the administration of President Barack Obama unveiled its 88-page proposal vastly to overhaul the financial regulatory framework in the United States. The ambitious proposal touches virtually every aspect of the U.S. financial regulatory system. It includes provisions that bring hedge

funds and private equity funds under the regulatory umbrella, and it creates a new agency, called the Consumer Financial Protection Agency, dedicated to regulating consumer financial products such as credit cards and home mortgages.

The proposal gives the Federal Reserve increased supervisory authority over large financial institutions whose problems could pose significant economic risks to the broader financial system, and it expands the authority of the Federal Deposit Insurance Corporation to seize and break up troubled institutions. The proposal calls for the U.S. Office of Thrift Supervision to be disbanded and for all current thrift institutions to be turned into banks. The proposal designates the U.S. Securities and Exchange Commission ("**SEC**") and the U.S. Commodities and Futures Trading Commission ("**CFTC**") as the regulators of the over-the-counter derivatives market. Under the proposal, the SEC would take over the regulation of the credit default swaps, and the CFTC would regulate other derivatives, including those related to interest rates and commodities. Both agencies would have the authority to subject derivatives dealers to capital, margin, and disclosure requirements, as well as position limits. In order to fill in remaining regulatory gaps, the proposal calls for a new Financial Services Oversight Council, led by the Treasury secretary, which would identify potential risks and allocate regulatory responsibility.

The proposal is now in the hands of Congress, which is responsible for drafting the legislation that would amend the dozens of statutes involved in this regulatory overhaul. Nonetheless, the final legislative product is likely to be strongly influenced by lobbyists and interest groups that oppose aspects of the Obama proposal. Financial regulatory reform on the scale proposed by President Obama could still be some time away, but the administration has stated that such reform is a political priority and has vowed to push its regulatory reform agenda forward.

For a link to the proposal document, please click here **...**

For a link to the Linklaters briefing on the proposal document, please click here **...**

9. U.S. Representatives criticise DOJ's use of deferred- and non-prosecution agreements: 25 June 2009

On 25 June 2009, members of the Judiciary Committee of the United States House of Representatives issued statements that were critical of the United States Department of Justice's ("**DOJ**") increasing use of deferred-prosecution agreements ("**DPAs**") and non-prosecution agreements ("**NPAs**") to resolve civil and criminal allegations against companies. In particular, the representatives attacked former New Jersey Attorney General Christopher Christie for his role in appointing John Ashcroft, the former United States Attorney General and Mr. Christie's boss, as an independent monitor of Zimmer Inc.'s DPA, an arrangement that allegedly resulted in $52 million in fees being paid to Mr. Ashcroft's firm. The representatives, Democratic Congressmen Frank Pallone and Bill Pascrell, both of New Jersey, have submitted a bill before Congress that would require the DOJ to develop guidelines to govern its decision to seek DPAs or NPAs rather than criminal sanctions. The proposed legislation would place a cap on the fees that are to be paid to the independent monitors who are often required under the agreements. The legislation would also give the courts, not the DOJ, final say on the selection of independent monitors.

In the last several years, the DOJ's use of DPAs and NPAs to resolve allegations ranging from fraud to securities violations has increased dramatically. Under a typical DPA, the government agrees to defer prosecuting a company for the company's alleged violations (or not to prosecute a company in the case of an NPA) in exchange for payment to the government of a monetary fine, continuing co-operation, changes in company policies, the hiring of an independent monitor, or other measures. The government argues that its use of DPAs and NPAs mitigates the "collateral consequences" caused to employees, shareholders, and the public at large when companies are prosecuted and, perhaps, forced out of business.

10. Former U.S. Representative becomes first elected U.S. official to be tried for FCPA violations: 16 June 2009

On 16 June 2009, former Louisiana congressman William Jefferson of the United States House of Representatives became the first elected official in the United States to be tried for allegedly violating the Foreign Corrupt Practices Act ("**FCPA**"). Congressman Jefferson, charged in a 16-count indictment alleging, in addition to FCPA violations, charges of money laundering, obstruction of justice, soliciting and accepting bribes, and wire fraud, is being tried in U.S. federal court in Alexandria, Virginia, and faces a sentence of up to 235 years in prison if convicted on all counts.
According to the government's complaint, Congressman Jackson is alleged to have paid and received bribes (including $90,000 wrapped in aluminium foil and placed in a freezer, which the Federal Bureau of Investigations found during a raid of Congressman Jefferson's Washington home) in an effort to cultivate business opportunities in West Africa for U.S. businessmen. Congressman Jefferson's trial is

yet more evidence of the government's increased prosecutorial activity under the FCPA.

11. Major settlement indicates increased FCA enforcement: 28 May 2009

On 28 May 2009, the DOJ announced that Aventis Pharmaceutical, Inc. ("**Aventis**"), a wholly-owned subsidiary of Sanofi-Aventis U.S., agreed to pay $95.5m to settle civil False Claims Act ("**FCA**") violations pending against Aventis. The allegations asserted that between 1995 and 2000, Aventis had profited by knowingly misreporting best prices for three steroid-based nasal sprays: Azmacort, Nasacort, and Nasacort AQ. Federal law requires that pharmaceutical companies report the best prices for their drugs to the government and that they provide those rates to state-administered, federally funded Medicaid. Aventis has not admitted to any wrongdoing, but the prosecution is part of a trend by the government to ramp up its FCA enforcement activities.

For further information on these stories, please contact Aaron DeLong, Ulysses Smith or Sheila Chithran in our New York office.

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