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CLIENT ALERT

IAN HANNAM - MUCH NEEDED CLARITY ON MARKET ABUSE?

Last month the Upper Tribunal (the **"Tribunal"**) rejected an appeal by Ian Hannam (**"Hannam"**) against the Financial Services Authority's (**"FSA"**) (predecessor to the Financial Conduct Authority) controversial 2012 decision that he had committed market abuse. Few cases have caused more discussion amongst London's bankers than the FSA's pursuit of Hannam for market abuse. Some commentators take the view that the FSA acted inappropriately by fining Hannam for simply doing what bankers have always done - sharing bits of information with potential investors to generate interest in a client. Others believe that the FSA behaved in an equitable way enforcing its rules against disclosure of inside information.

Regardless of the view held, the Tribunal's decision sends a clear message as to what conduct will be classified as market abuse and the consequences of failing to follow internal procedures for dealing with inside information.

BACKGROUND

In February 2012, the FSA fined Hannam, the former Chairman of Capital Markets at JP Morgan and Global Co-Head of UK Capital Markets at JP Morgan Cazenove (**"JPMC"**), £450,000 for improper disclosure of inside information contrary to section 118(3) Financial Services and Markets Act 2000 (**"FSMA"**). The FSA claimed that Hannam had improperly disclosed inside information, but accepted that no trades were conducted as a result of the disclosure and Hannam's honesty and integrity was not in question. Hannam challenged the decision in the Tribunal, and after lengthy consideration, judgement has been handed down.

Since 2007, Hannam acted as lead corporate adviser to JPMC's client, Heritage (an oil and gas exploration and production company) and its CEO, Tony Buckingham. Hannam was instructed to secure a substantial corporate transaction for Heritage, e.g. a merger, consolidation, take-over or joint venture.

Heritage was conducting exploration drilling projects in Uganda and the Kurdistan Region of Iraq during Autumn 2008. At the same time, Hannam had two other clients with interests in Kurdistan, Mr 'A' and Mr 'B'. The case centred on two emails (the "September email" and the "October email") which, it has been held, disclosed inside information to Mr A and Mr B.

The September email (dated 9 September 2008) from Hannam to Mr A read:

> "*I thought I would update you on discussions that have been going on with a potential acquirer of Tony Buckingham's business. Tony, advised by myself, has deferred engaging with the client until Thursday of next week although we know they are very excited*

> *about the recent drilling results of Heritage Oil and today's announcement by Tullow. I believe that the offer will come in in the current difficult market conditions at £3.50 - £4.00 per share. I am not trying to force your hand, just wanted to make you aware of what is happening*"

The October email (dated 8 October 2008) sent on Hannam's instructions to Mr A and blind copied to Mr B read:

> "*PS - Tony [Buckingham] has just found oil and it is looking good*."

The FSA claimed that:

- the September email disclosed that JPMC was engaged in ongoing discussions with a potential acquirer of Heritage, at a time when Hannam knew that Mr A might recommend that the organisation he represented should purchase a share in Heritage; and
- the October email disclosed that Heritage had just made an oil discovery, which was again sent at a time when Hannam knew of Mr A's interest in Heritage shares.

Although it was subsequently discovered that neither communication was accurate, e.g. no substantial bid materialised as predicted and Heritage had only found a preliminary indication of oil, the FSA nevertheless considered the information disclosed to be "inside information".

SUMMARY OF THE LAW

For the purposes of section 118(3) FSMA, a person engages in behaviour amounting to market abuse where they are an insider; disclose inside information to another person; and the disclosure is made other than in the proper course of their employment, profession or duties.

In this case it was accepted that Hannam was an "insider" since he had access to the information as a consequence of his employment. Section 118C FSMA defines "inside information" as information "which is of a precise nature" and "price sensitive". Information can be considered "precise" where it indicates events that have happened or are likely to happen, and are specific enough to conclude the possible effect it will have on the price. Information is "price sensitive" if a reasonable investor would be likely to use it as the basis of his investment decisions.

The FSA pursued action against Hannam on the basis that his disregard for JPMC's procedures for handling market-sensitive information also constituted a serious violation of the market abuse law. In his defence Hannam claimed that the two emails did not contain inside information, as the information was not entirely accurate and therefore not precise enough to be price sensitive. In the alternative, he stated that he was acting in the proper course of his employment and acting in his client's best interests by trying to facilitate a corporate transaction. Therefore the disclosure could not amount to market abuse.

UPPER TRIBUNAL DECISION

The arguments advanced by Hannam were considered by the Tribunal in a de novo review - a fresh review of all the evidence by the appellate court without deference to any previous decision. The Tribunal confirmed that the emails disclosed "inside information" and should have been kept confidential in accordance with UK Takeover Code rules. It also rejected Hannam's argument that he had acted in the course of his employment, as he had failed to follow internal JPMC procedures on the handling of such information, which required him to impose an obligation of confidentiality upon the recipient of the information (e.g. wall-cross the recipient). Despite giving evidence, the Tribunal rejected Hannam's assertion that the recipients knew that they were to keep the information confidential and that he had discussed the issue of confidentiality with Mr A prior to sending the emails.

Although it was accepted by both the FSA and the Tribunal that Hannam had acted neither deliberately nor recklessly, the Tribunal held that he had exercised a serious error of judgement in relation to the sending of both emails. In addition, despite being told that Hannam had his client's consent to make the disclosure, the Tribunal considered the consent insufficient for compliance purposes. In the Tribunal's opinion Hannam should have been aware through his senior position and extensive experience that he was disclosing inside information and should therefore have taken the appropriate measures to protect that information.

DISCUSSION POINTS

It was not part of the FSA's case that Hannam deliberately set out to commit market abuse or that he lacked honesty or integrity. Furthermore, the FSA acknowledged the inside information was not used by either Mr A or Mr B to deal, so the information arguably remained confidential. This has led some commentators to question why the regulator penalised an apparently honest man, who coincidentally was also one of London's most prolific corporate bankers at a time of general hostility towards bankers. How much weight can be placed on this point is debatable - the Tribunal accepted the FSA position that Hannam had not deliberately set out to commit market abuse, but repeatedly commented on the inconsistency of his evidence.

Some changes are potentially on the horizon for the FCA's enforcement decision making process. On 6 May 2014, the Chancellor of the Exchequer announced that HM Treasury would review the enforcement decision making processes for the FCA and the Prudential Regulation Authority (**"PRA"**). The review will consider whether the institutional arrangements and processes that the FCA and PRA have in place in relation to their enforcement processes strike an appropriate balance between fairness, transparency and efficiency. Against this background, it might be said that Hannam was an unfortunate victim at a time when the FSA (as it was) was intent on self-preservation.

Other commentators take the opposite view, that the FSA was correct to take a firm stance on the disclosure of sensitive information as an integral part of its role of maintaining an effective UK financial market. Bankers and financial advisers in a corporate adviser role who discuss client price-sensitive affairs with those that might further their client's interests are understandably concerned that this decision will stifle their ability to perform their roles. Although casual leaking of sensitive information may be commonplace amongst banking professionals trying to close deals for their clients in the London markets, this case reiterates that such behaviour amounts to an offence.

The decision also emphasises that there are legitimate ways for bankers to share confidential corporate information, such as "wall-crossing" recipients, where potential investors sign a confidentiality agreement that lets them "cross the wall" and legitimately receive inside information. The Tribunal also took account of the JPMC disciplinary proceedings against Hannam in its judgement. JPMC found that his conduct had fallen "below the standard expected…and on at least one occasion it appears that you have imparted confidential information to a client, without being able to give a proper explanation for why this was appropriate." As a senior banker at JPMC and an approved person, the Tribunal concluded that Hannam should have been aware that he was in possession of inside information and the requirement to follow internal procedures.

CONCLUSION

One of the reasons Hannam appealed the 2012 decision to the Tribunal was to clarify the application of market abuse rules as they related to his case. But the action taken by the FSA and the judgement handed down by the Tribunal suggest that the position on market abuse is clear.

The following key points emerge from this case:

- the standard of proof to be applied in market abuse cases is the civil standard, on the "balance of probabilities", despite the quasi-criminal nature of the proceedings;
- "inside information" can include information which is not entirely accurate or information which has already been partially disclosed (especially in circumstances where disclosure by the insider will give credence to the previously disclosed facts), but would not include information which is false;
- persons with "inside information" must be cautious in its handling and should think carefully before disclosing it; and
- the individual must have followed their own internal company procedures and other applicable rules, such as the Takeover Code, to rely on the statutory defence (section 123(2)(a) FSMA) of having acted in the "proper course of his employment, profession or duties".

Whatever the FSA's motive for pursuing Hannam, this judgement has concerned those operating in the industry. It sends a clear message as to what conduct will be classified as market abuse and the consequences of failing to follow internal procedures for handling inside information e.g. obtaining confirmation that the recipients knew that they were being wall-crossed. Action will be taken by the regulator even where, as in this case, it was on Hannam's instructions that the matter was brought to the regulator's attention. Whether the FCA takes a different stance in the future is likely to depend on the results of the HM Treasury review.

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