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Five Years of Market Abuse

On 1 December 2006, the market abuse regime in the UK 'celebrated' its fifth anniversary. While the Financial Services and Markets Act 2000 ('FSMA') was passing through Parliament and then being implemented, the provisions of Part 8 on 'Penalties for Market Abuse' remained some of the most controversial. Until 2001, self-regulating organisations, like the Stock Exchange, and then the Securities and Futures Authority had disciplined member firms and occasionally individuals within them for breaches of market discipline rules. The Stock Exchange also imposed rules, including the Model Code on Directors' Dealings on quoted companies, but otherwise behavioural control of dealing in securities was largely left to the criminal law.

During the 20th century, specific financial crimes of making 'misleading statements', 'market manipulation' and 'insider dealing' were created, but proving the elements of these crimes 'beyond reasonable doubt' meant successful prosecutions were few and far between.1 Even when prosecutions for market misconduct were pursued, the authorities preferred to use more general charges like conspiracy to defraud by rigging a market or provisions of the Theft Act for fear of the technicalities of the specialist crimes. Frustration with the difficulties of prosecution led the Government to give the Financial Services Authority ('FSA') the power to fine authorised and non-authorised persons for 'market abuse' based on a civil burden of proof. As the Economic Secretary put it:⇧

> 'there is a gap in the protections [of the financial markets]. The criminal law covers all market participants, but only a narrow range of serious criminal offences. The regulatory regime is capable of dealing with a wider range of damaging behaviours, but applies only to the regulated community.'2⇧

The proposal to have a sweeping civil sanction was much criticised in the hearings of a Joint Committee of Parliament.3 This resulted in the Government making a number of amendments during the legislation's passage through Parliament and leaving the FSA, as the only body allowed to bring an action for market abuse, a wide discretion to develop guidance as to what exactly it would view as market abuse. This guidance was to be published as a Code of Market Conduct ('COMC') and the current version is to be found in the Market Conduct ('MAR') section of the FSA's Handbook.4

1 Prevention of Fraud (Investments) Act 1939, s 13, Financial Services Act 1986, s 47(2) and Companies Act 1980, Part V, now FSMA, s 397 and Criminal Justice Act 1993, Part V.

2 Economic Secretary in Standing Committee A, 2 November 1999, c 652. The ability of an outsider to undermine a market was demonstrated by the effect Sumitomo Bank had on the London Metal Exchange even though it was not a member of that exchange, see Lord Bagri (Hansard Vol 610 HL, 21 February 2000, c 58).⇧

3 Joint Committee, Second Report; Standing Committee A, 2 November 1999, cc 651 to 708. ⇧

4 FSMA ss 119 to 122. References to the original Code will be given as COMC, and to the current Code as MAR.

Before the FSMA came into force, the FSA conducted protracted consultation with the industry on this guidance.[5] The original COMC dwelt quite heavily on what 'mens rea' should be shown in order to prove market abuse. This was because, although the statutory definition of market abuse made no reference to any 'mens rea', it did require behaviour to be 'likely to be regarded by regular users of the market as falling below the standard expected of a person in that position' (the 'regular user test').[6] The FSA itself admitted that objectively similar behaviour may or may not be legitimate depending on the motivation and stressed:

> '… the new market abuse regime is not intended to affect activities which form part of the normal transaction of business on prescribed markets. Such activities will include, amongst others, position-taking, market-making, the execution of customer orders and hedging.'[7]

In the meantime, the European Union adopted a Level 1 Market Abuse Directive ('MA Directive')[8] as part of the Financial Services Action Plan, with Level 2 implementing measures following shortly thereafter.[9] Although modeled on the UK example, the European legislation set minimum requirements that did not follow the distinctions in the COMC, nor did it have a 'regular user test' to allow the FSA to retain those distinctions. On the other hand, there was some concern that the European minimum did not cover all the forms of market abuse covered by the UK legislation and the UK government decided to legislate for the European minimum to come into force on 1 July 2005 and retain, at least for three years, the existing UK provisions.[10]⇧

Although in force since late 2001, FSA rulings on the market abuse provisions and 'appeals' to the Financial Services and Markets Tribunal ('FSMT') only began to be reported in 2004 and to date, have only been on the old UK provisions. Nevertheless, a picture is beginning to emerge about whether the market abuse regime has filled in 'a gap in the protections' and the cases have helped to clarify a number of the controversial issues, namely to what extent:

1. have market abuse proceedings remained really criminal rather than civil;
2. has the COMC reduced the scope of market abuse back to the pre-existing criminal offences; and
3. has the FSA needed and used market abuse proceedings as against the other enforcement weapons available like, criminal prosecutions, proceedings against quoted companies for breaches of Part 6[11] rules or disciplinary proceedings against authorised persons and approved individuals?

Criminal or Civil

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5 Consultation Paper 10, FSA, June 1998; Feedback Statement, FSA, June 1999; Consultation Paper 59, FSA, July 2000.

6 FSMA s 118(1), as originally passed.

7 Consultation Paper 59, para 6.13.

8 2003/6/EC.⇧

9 Directives 2003/124/EC and 2004/72/EC and Regulation (EC) 2273/2003.⇧

10 Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, SI 2005/381.

11 These include the FSA's listing, disclosure and transparency rules.

Undoubtedly the major reason for introducing the market abuse regime was to circumvent the procedural rigours and evidential standards involved in criminal prosecutions. However, calling something a civil procedure does not make it one for the purposes of the European Convention on Human Rights Articles 6 and 7 and shortly after the FSMA came into force, the case of *Fleurose*,12 examined the position under the Convention, albeit on facts arising from disciplinary proceedings under the pre-FSMA arrangements.

At 1st instance, Morison J reviewed the jurisprudence of the European Court of Human Rights on these issues and concluded, following *Engel v The Netherlands*13 that to decide whether proceedings were criminal or civil, a three stage test had to be applied:

(1) Has the Contracting State classified the case as subject to disciplinary law or criminal law?
(2) What is the nature of the offence charged?
(3) What is the nature and severity of the penalty that was or might have been imposed?

Morison J concluded that, although disciplinary proceedings could lead to an unlimited fine, they remained a civil debt and could only be imposed upon a section of the community who had volunteered to participate in financial services and thus required to become authorised or a registered employed of an authorised firm. On the basis of the decision in *Wickramsinghe v UK* 14 the proceedings should be classified as civil. However, by the same reasoning, as market abuse can impose an unlimited fine on anyone, authorised or not, it should be treated as criminal for Convention purposes, the approach taken by the Court of Appeal to fines imposed for the non-payment of tax in *Han v Commissioners of Customs and Excise.*15.

Under the FSMA regime, the FSMT has confirmed that it views market abuse proceedings as criminal for the purposes of the Convention in both *Davidson and Tatham* and *Parker*.16 The Convention does not, however, deal with the evidential standard, which has been an issue in a number of FSMT hearings.

It has been recognized in English Law that where civil cases imply criminal or quasi-criminal behaviour, the standard of proof should be affected, not least to reduce the possibility of OJ Simpson type situations.17 However, the explanations given about the evidential standard have varied from case to case. In *Hornal v Neuberger Products Ltd*, Denning LJ talked of a sliding scale, 'the more serious the allegation, the higher the degree of probability that is required.'18 This seems to have led to courts dealing with

12 *R (Fleurose) v Securities and Futures Authority Ltd* [2001] IRLR 764 affirmed on slightly different grounds in [2002] IRLR 297, CA.

13 [1987] 1 EHRR 647

14 [1998] EHRLR 338.

15 [2001] 4 All ER 687.

16 *Davidson and Tatham v FSA* (2006) FSMT Case 031; *Parker v FSA* (2006) FSMT Case 037

17 The American sportsman, OJ Simpson, was acquitted in a criminal trial of being responsible for the death of his girlfriend, but then found liable for the death in civil proceedings.

18 [1956] 1 QB 247.

contempt of court, anti-social behaviour orders and disciplinary cases in the legal field to state that they were applying the full criminal standard of 'proof beyond reasonable doubt.'[19] The Court of Appeal, however, has since said that such cases are exceptional and the general rule remains 'proof on the balance of probabilities'.[20] Nevertheless, the House of Lords has said, when applying that test, 'the more serious the allegation, the less likely it is that the event occurred and hence the stronger should be the evidence.'[21]

This does seem a weaker formulation than Denning's sliding scale and it is this weaker formulation that has been adopted by the FSMT in *Davidson and Tatham* and in *Parker*, although in the earlier case of *Mohammed Arif*[22] the FSMT adopted the sliding scale. The weaker formulation might suggest a reluctance to apply a criminal standard to market abuse proceedings, but in *Davidson and Tatham*, the tribunal said that for such a serious case, the civil standard would produce the same or similar results to the criminal standard,[23] wording very similar to that used in *Mohammed Arif* when using the sliding scale.[24]

It appears, therefore, that in any serious allegation of market abuse implying a possible criminal offence like insider dealing or misleading statements and practices, the standard of proof is unlikely to be much if any easier than in bringing a prosecution. So, if market abuse proceedings are to be easier to bring than prosecutions, it is going to be because what needs to be proved is less onerous.

The Pre-Directive Position

The COMC introduced when the FSMA first came into force did much to clarify what the FSA expected to have to prove in the then three types of market abuse, misuse of information (akin to insider dealing), false and misleading impression (akin to misleading statements and practices) and distortion (rigging a market). It was the product of considerable consultation with the industry and, in particular, highlighted what *mens rea* would be needed to be shown in each case.

In addition to the three primary types of market abuse, the FSA could (and can still) fine any person for 'encouraging or requiring' another to act in a way which, if the instigator person had done so would have amounted to market abuse.[25] Technically, the FSA's COMC does not apply to such indirect market abuse, but as the whole point of this secondary market abuse is to aggregate the encouraged or required *actus* reus with the *mens* rea of the instigator, any COMC provisions on both elements must still apply, other wise the whole package would not amount to market abuse if it had all been done by the instigator.

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19 *Re a Solicitor* [1993] QB 69; *B v Chief Constable of Avon and Somerset Constabulary* [2001] 1 WLR 340, DC; *R (McCann) v Crown Court at Manchester* [2003] 1 AC 787, HL; *Campbell v Hamlet* [2005] 3 All ER 1116, PC.

20 *R(N) v Mental Health Review Tribunal* [2006] QB 468.

21 *Re H* [1996] 1 All ER 1 at 16, per Lord Nicholls, following a similar formulation in *Re Dellows Will Trusts* [1964] 1 WLR 451 at 455, per Ungoed-Thomas J.

22 *Mohammed Arif v FSA* (2005) FSMT Case 012.

23 Case 031 at p 43.

24 Case 012 at p 9.

25 FSMA s 123.

Misuse of Market Information

For market abuse based on the misuse of market information, four elements had to be shown:

1. the behaviour was based on the information, ie some knowledge on the part of user of the information's quality (favourable or unfavourable);
2. the information was not generally known, ie an objective test, not dependent on whether the user knew or even ought to have known;
3. the information was relevant, ie a materiality rather than a price sensitivity test; and
4. the information would reasonably be expected to be announced because of a legal or regulatory duty or because it was routinely announced (eg credit ratings).[26]

Proving information held was objectively material is easier than showing someone knew or ought to have known it was price-sensitive as required for the crime of insider dealing. Whereas price-sensitive information is bound to be material to a reasonable investor, material information is not bound to be price-sensitive. For example, a reasonable investor may have strong but individual political or ethical views on the location or type of an issuer's activities (ie 'material') not shared by enough others to affect the price of the issuer's securities (ie 'price-sensitive'). Also, 'price sensitivity' tends to rely on subsequent evidence of price movements which can always be challenged as 'being wise after the event', as seen in the Irish case of *Fyffes plc v DCC plc*[27] compared to the ease of proving materiality in the FSMT cases of *Arif Mohammed* and *Parker*.[28] On the other hand, the requirement that the information be expected to be announced was an extra hurdle compared to the criminal offence and one that defeated the FSA's case in *Davidson and Tatham*[29] where it could not be shown what the obligation was on a major shareholder to disclose pre-IPO derivatives dealings aimed at ensuring the successful launch of the IPO.

One type of insider dealing not so clearly covered by market abuse was wrongful disclosure leading to dealing, unless it could be claimed that it amounted to the secondary market abuse of encouragement. The COMC also contained a safe harbour for trading information (ie knowledge that someone intended to deal) that went further than the defence in the criminal legislation. Because firms or companies could commit market abuse (unlike the crime which is confined to individuals), there was also a safe harbour where it could be shown that employees or agents in possession of the information were not involved in the deal. This was to overcome the problem of attributing their knowledge to their principal.[30]

False and Misleading Impression

In the original COMC four types of behaviour were defined under this heading:

26 COMC 1.4.4

27 [2005] IESC 3 (Sup Ct (Irl))

28 (2005) FSMT Case 012 and (2006) FSMT Case 037

29 (2006) FSMT Case 031.

30 COMC 1.4.19-1.4.30.

1. *Artificial transaction(s)*, where a person knew or could reasonably be expected to know that their principal effect would be, or would be likely to be, to inflate or depress the apparent supply, demand, price or value such that a false or misleading impression is likely to be given to a regular user, unless the regular user would regard the principal rationale for the transaction(s) in question as a legitimate and their execution proper.

2. *Artificial course of conduct*, basically the same as 1. above but covering courses of conduct not involving transactions (eg underlying commodity movements).

3. *Disseminating information* where a person knew or could reasonably be expected to know that information was relevant and false or misleading and disseminated it in order to create a false or misleading impression (this need not have been the sole purpose for disseminating the information but would be an actuating purpose).

4. *Dissemination of information through an accepted channel*: where information was to be disseminated, for example, through the Regulatory News Services, the person responsible for its submission remained under a positive obligation to take reasonable care to ensure that it was not false or misleading.[31]

In the first three types, constructive knowledge of the likely effect of the activities might have made proof marginally easier than under FSMA s 397, but for the 'principal rationale' or not 'actuating purpose' defences, but in the fourth type, a duty of care was presumed, breach of which would be sufficient. This last type added individual liability for quoted companies issuing (or failing to issue) information as well corporate liability for breach of Part 6 rules, like listing rules.

Again, the COMC contained safe harbours, including where the dissemination of information by a firm or company was through an innocent employee (eg because of a Chinese Wall) to avoid the problems of attribution.

Distortion

Before the introduction of the European provisions, the FSA considered that there were two circumstances which could be defined as abusive distortion:⇧

1. *Abusive squeezes*: where, with a purpose of distorting prices, a person had a significant influence over supply, demand or delivery mechanisms of an investment or the underlying product; *and* directly or indirectly held positions under which he expected delivery of them. It was the combination that could be abusive.

2. *Price-positioning*: where a person entered into transactions or a series of transactions a purpose of which was to move the price materially higher or lower, ie ramping prices of an investment or a relevant index.[32]

Both of these were really back stops as in most circumstances, such activities would also have been caught by the false or misleading impression provisions.

The Post-Directive Position

The MA Directive set a minimum standard aimed only at protecting European regulated markets. The UK Government extended protection, so that after 1 July 2005, the UK provisions apply to financial instruments that have requested or have been admitted to

31 COMC 1.5.8–1.5.22. ⇧

32 COMC 1.6.9-1.6.19.⇧

trade on any exchange in the UK, including the AIM and Plus Market (formerly OFEX), and any other European regulated market, plus in respect of insider dealing or improper disclosure, related investments (non-traded options, futures etc) based on such traded instruments.33 However, to reduce extra-territoriality, the FSA may only act if either the behaviour or the instrument affected is, or has requested to be traded, in the UK.

It is irrelevant that the principal market of an affected instrument and any dealing involved is outside Europe if the instrument is admitted to one of these European markets.34 It used to be slightly less clear whether behaviour before the request to be admitted to trading could be caught. It was held in *Davidson and Tatham* that failure to disclose spread bets taken out before trading started (the start point before 2005) could still be behaviour after trading started.35 The MAR reaffirms this in respect of behaviour before a request for admission is made.36

Profit throughout includes 'potential profit, avoidance of loss or potential avoidance of loss', and behaviour still does not have to be deliberate.37 Otherwise, behaviour in respect of the European provisions does not seem quite so wide a concept as for the UK provisions. It may be by one or more persons and includes inaction, on which the COMC gives two factors the FSA will consider, failure to discharge a legal or regulatory obligation or creating a reasonable expectation and then not correcting it.38 However, it has to be 'in relation to qualifying investments' or, for insider dealing and improper disclosure, 'related investments' (see above). It does not specifically extend to behaviour in relation to any underlying subject matter of a qualifying investment that is not itself qualifying (eg commodities).39

Although the MA Directive refers only to two forms of market abuse, insider dealing and market manipulation, the FMSA 2000 has split the former into insider dealing and improper disclosure, and the latter into manipulating transactions, manipulating devices and dissemination.

Insider Dealing

This form of market abuse requires the person to be an 'insider'. However, this can be anyone in possession of inside information however obtained, though it has to be shown that he knew or ought to have known that it was inside information except in certain cases, namely where it is as a result of:⇧

33 FSMA 2000, s 118(1); Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 as amended ('2001 Order'), arts 4 and 5. The extension of qualifying investments to non-European regulated markets, like AIM and OFEX is a UK extension not required by the MA Directive.⇧

34 *Jabre v FSA* (2006) FSMT Case 036 on the earlier more ambiguous wording. Jabre dealt in a Japanese shares through Japan, but was caught because he was in London and the shares were also on London's International SEAQ, now the International Bulletin Board.⇧

35 (2006) FSMT Case 031. Davidson and Tatham won on a different point.⇧

36 MAR 1.2.5E.⇧

37 MAR 1.1.8G and 1.2.3G.⇧

38 FSMA s 118(1)(a); MAR 1.2.6E.⇧

39 FSMA s 118(1); cf s 118A(3) applying to the UK provisions.⇧

(1) being a director, manager or shareholder;

(2) having access to the information through his employment, profession or duties; or

(3) criminal activities.40

Even in these cases, 'as a result of' implies some causal connection, though it could be quite weak, eg the cleaner emptying confidential papers in the office, though perhaps not the stockbroker sent by his employers on a train and witnessing a factory burning down, but see below.

The European definition of inside information seems narrower than that of misuse of information in the UK provisions, because it not only requires that information relate to qualifying investment(s) and not be generally available, but also be:⇧

(1) precise (except in the case of commodity derivatives where it has to be disclosable/announceable instead); and

(2) likely to have a significant price effect.41

However, 'precise' has a very extended meaning, including 'reasonably expected to come into existence or … to occur' and specific enough to allow a conclusion 'as to the possible effect'.42 The definition of 'significant price effect' is even more confused, because in one of the level 2 implementing Directives, it is defined as 'information which a reasonable investor would be likely to use as part of the basis of his investment decisions', ie a materiality test.43 ⇧

The UK Government has adopted the logical but untested view that a level 2 definition cannot extend a level 1 one,44 producing an odd provision stating that price-sensitive information must at least be material.45

On the other hand, the European definition may be wider than the UK in two respects:

(1) in confining the disclosable or announceable test to commodity derivatives rather than all qualifying investments;46

(2) trading information can be inside information in some circumstances (safe harboured under the UK provisions).47⇧

There are general safe harbours in respect of all market abuse for buy-back

40 FSMA s 118B.⇧

41 FSMA new s 118C(2) and (3).⇧

42 FSMA new s 118C(5).⇧

43 2003/124/EC, Art 1.⇧

44 MA Directive, Art 1(1).⇧

45 FSMA new s 118C(6).⇧

46 FSMA s 118C(3) and (7). This may reverse the decision in *Davidson and Tatham*. ⇧

47 FSMA s 118C(4). Only trading on one's previous decision, bona fide principal trading or faithfully carrying out an order is now safe harboured, MAR 1.3.6C, 1.3.7C and 1.3.12C.⇧

programmes and stabilisation conducted in accordance with new European rules,48 and the FSA has trawled the European Directives to find other matters that are conclusively not insider dealing. However, at least one former safe harbour, that those effecting the deal were not influenced by the information, has been downgraded to a factor.49 This safe harbour was thought to be needed because firms or companies can be 'guilty' of market abuse and the UK has strict knowledge attribution rules. However, firms or companies should be able to rely on the argument that the basic requirement that the dealing be 'on the basis of inside information' was not met.50⇧

Do the European provisions on 'insider dealing' make market abuse proceedings easier than under the old UK provisions? In sticking to a price-sensitivity test and requiring constructive knowledge for some insiders that they have inside information, the answer is probably no, except in one area…

Improper Disclosure

The European provisions do clear up one oddity of the old UK provisions, namely by this extension of insider dealing to 'disclosing' (other than in the proper exercise of one's employment, profession or duties), as well as 'dealing' and 'encouraging'.51 Disclosing in a social context or selective briefing of analysts is caught.52 There are safe harbours for disclosures to official and regulatory bodies or complying with Part 6 rules.53 A confidential warning may still indicate that a disclosure is not market abuse, but only if the disclosure is for some proper purpose.54 What this seems to remove compared to the crime of insider dealing is any defensive argument that the tipper did not expect any tippee to deal, eg a husband giving his wife information to explain current long hours at work. Improper disclosure also catches encouraging another to disclose and so pressing an insider for inside information may be encouraging.55⇧

Manipulating Transactions

This European provision covers effecting or participating in effecting transactions or orders to trade which:

(1) are likely to give a false or misleading impression of a market or price in an qualifying investment; or

(2) secure an abnormal or artificial price level,

but in effect with a defence of having 'legitimate reasons in conformity with accepted

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48 FSMA new s 118A(5).⇧

49 MAR 1.3.3E.⇧

50 MAR 1.3.4E and 1.3.5E.⇧

51 FSMA s 118(3).⇧

52 MAR 1.4.2E.⇧

53 MAR 1.4.3C.and 1.4.4C.⇧

54 MAR 1.4.5E.⇧

55 MAR 1.4.7G.⇧

market practices'.[56]

This form of market abuse (together with manipulating devices below) covers much the same area as artificial transactions, price positioning and abusive squeezes under the UK provisions.[57] The MAR gives factors as to what might or might not be 'legitimate reasons', which do look, inter alia, at motive.[58] However, what is notably lacking in the new proposals is any positive requirement for a subjective mens rea that was considered so important in trying to distinguish legitimate from illegitimate activities under the UK provisions.[59] Also accepted market practices cannot be as wide as the regular user test because by definition it cannot be used to defend any innovation. The only specific reference to them is to the 'metal markets aberration scheme',[60] but at least stock lending and repo transactions are deemed not to be wash trades.[61] One feature of the UK provision's scope that may not be fully captured by this European definition is artificial conduct because the definition depends on 'transactions or orders to trade'.

Otherwise, however, the European drafting seems wider.⇧

Manipulating Devices

This is an extension to manipulating transactions and covers effecting or participating in effecting transactions or orders which employ fictitious devices or any other form a deception or contrivance. This includes:

(1) publicising possibly true views about a qualifying investment in which one has a position without disclosing the conflict;

(2) structuring transactions to conceal true ownership;

(3) 'pump and dump' or 'trash and cash', publishing misleading information to profit from a long or short position.

In the factors the FSA will consider are links between the persons disseminating information and those trading.[62]

Dissemination

This consists of 'the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew, or could reasonably be expected to have known that the information was false or

56 FSMA s 118(5). There are also the general statutory safe harbours for stabilisation and buy-backs, see above.⇧

57 MAR 1.6.2E, 1.6.4E, 1.7.2E and 1.7.3E.⇧

58 MAR 1.6.5E and 1.6.6E.⇧

59 Alistair Alcock, 'Market Abuse' (2002) 23 CoLaw 142, 144 to 146. Also see UK Provisions below.⇧

60 MAR 1.6.14E.⇧

61 MAR 1.6.3G.⇧

62 MAR 1.7.2 and 1.7.3.⇧

misleading'.[63] Little further guidance is given in this case. Dissemination may be wider than the UK provision in two vital respects:⇧

(1) there is no longer a safe harbour, just a factor against a firm being deemed to know information is false or misleading when one of its employees knows it is and another disseminates it in ignorance. Authorised firms may be able to rely on a formal Chinese Wall as a defence.[64]

(2) Gone is the old distinction between those responsible for 'dissemination through an accepted channel' who were under a positive duty of care to ensure accuracy and others who were not. The latter had to have an 'actuating purpose' to create a false or misleading impression.[65] This subjective mens rea is vital to protect those passing on the tittle tattle and rumours on which markets thrive (including journalists) while catching those who set out to deceive.[66]

The special position of journalists, however, is recognised who have a partial defence if they follow journalistic codes and do not derive any direct or indirect advantage or profit from the dissemination.[67]

Continuing UK Provisions

As has already been noted, the three old UK forms of market abuse are to be retained until at least 2008 (although in the FSMA, 'false and misleading impressions' and 'distortion' have been grouped together now as 'misleading behaviour'). Still for these UK provisions:

1. the behaviour may be in relation to qualifying investments, derivatives based on qualifying investments, or any underlying investments (whether qualifying or not);[68]

2. the protection is only for investments traded on UK RIEs or Plus Market, *not* other European exchanges;[69] and

3. the behaviour is subject to the regular user test.[70]

Despite the retention of the old UK regime (including the regular user test) virtually in its original legal form, the FSA has in its MAR for these UK provisions abandoned its detailed guidance in the old COMC. In both MAR 1.5 and 1.9, clear definitions and safe

63 FSMA 2000, s 118(7).⇧

64 MAR 1.8.5E, 1.10.2G and COB 2.4.4R.⇧

65 Pre-2005 MAR 1.5.15, 1.5.16, 1.5.18 to 1.5.20. An actuating purpose did not have to be the principal purpose.⇧

66 The example in MAR 1.8.3E refers to 'knowingly or recklessly' (subjective) but the test in MAR 1.8.4E is based on 'a normal and reasonable person' (objective).

67 FSMA 2000, s 118A(4).⇧

68 FSMA s 118A(3). This more clearly captures dealing in any non-traded derivatives and underlying commodities for traded derivatives than the European definition.⇧

69 2001 Order, arts 4(2) and 5(2), although this could be extended to markets electronically available in the UK, FSMA s 118A(2).⇧

70 Referred to in both FSMA s 118(4) and (8).

harbours have been replaced by factors, generally following those in the equivalent European provisions. For example, for misuse of information, it is no longer incumbent on the FSA to show that the information is disclosable or announceable, but those remain factors when applying the regular user test.[71] So, if in the futre, facts like those in *Davidson and Tatham* are not caught by the European provisions on insider dealing, they might be caught by the UK's misuse of information.

Conclusion on the Substantive Provisions

Although the original UK definition of market abuse in FSMA, s 118 was very wide, sensible refinement had been introduced by safe harbours and guidance in the old COMC after much careful thought and consultation.[72] The new European provisions in s 118(2),(3),(5),(6) and (7) are, if anything narrower. On the other hand, the old COMC safe harbours, refinements and guidance have been sharply reduced and, in any case, without the regular user test, of more doubtful utility. The FSA seems to be left within these narrower definitions, a wider discretion to pursue individuals or firms and companies without having to show actual knowledge or improper purpose on the part of those involved..

A striking feature of the post-2005 MAR in respect of the UK provisions now found in s 118(4) and (8) is the removal of the detailed definitions that existed before. It is not clear that the FSA intended to widen the scope of market abuse except where required to by the MA Directive. Still, the overall effect does seem to have been to ease the burden on the FSA, particularly in proving any mens rea compared to the criminal offences.⇧

Enforcement

The FSA's enforcement powers have not been changed by the MA Directive, but to date, the only evidence we have of how the FSA uses its powers is for the period before the MA Directive came into force. The FSA has a range of sanctions which can be applied to anyone within and without the perimeter. The basic choice is whether:⇧

1. to seek an injunction from the courts;
2. to prosecute through the courts for insider dealing, or misleading statements and practices;
3. to publicly reprimand or impose its own fines for market abuse;
4. to impose its own restitutionary order for market abuse;
5. if the defendant is authorised or approved, use its own disciplinary procedures; or
6. if the defendant is a listed company, to publicly reprimand or fine the company (or any directors involved) for the breach of Part 6 rules.[73]

Injunctions

An injunction does not require there to have been a criminal offence or market abuse,

71 MAR 1.5.7E.

72 Alistair Alcock, 'Market Abuse' (2002) 23 CoLaw 142.⇧

73 Criminal Justice Act 1993, Part V; FSMA 2000, ss 66, 91, 123, 205, 206, 381, 384, 397, 402 and 403. The FSA's general approach to market abuse is contained in ENF, particularly Chapter 14.⇧

but the court must be satisfied that there is a ‘reasonable likelihood’ of one, or of one continuing. The injunction may extend to anyone ‘knowingly concerned’ in a crime (the wide definition of market abuse does not need such an extension). It can also order an asset freeze of those who may have already been involved.74 However, the FSA will really only consider seeking an injunction if there are serious continuing risks.75

In February 2007, the FSA obtained its first injunction to freeze assets in respect of market abuse.76⇧

Prosecution

The FSA has a Memorandum of Understanding with the other prosecuting authorities to determine how such a decision should be taken. Market misconduct will generally fall to the FSA. However, given the difficulties in prosecuting these types of offences, the FSA seems no keener than the other responsible authorities in the past to bring prosecutions for insider dealing or misleading statements and practices.77 The FSA had a partial success with its one and, so far, only prosecution against directors for recklessly misleading statements under FSMA, s 397.78⇧

Market Abuse Proceedings

Breaches of the COMC or now the MAR will not automatically lead to market abuse proceedings. The FSA has laid out the criteria that it will consider.79 Not all cases will warrant enforcement action, but relevant factors include the seriousness of the suspected behaviour, the past compliance record of the person and whether he had taken any remedial actions. This does make a case of publicly reprimanding but not fining unlikely, and to date there seems to have been no example of this. There are reasonable belief (that behaviour is not market abuse) and reasonable precautions (to avoid market abuse) defences to being fined (but not reprimanded) under FSMA s 123(2). The FSMT felt that these would have applied in *Davidson and Tatham* had it found the failure to disclose the derivatives dealings market abuse, which it did not.80

The FSA is required to publish a statement of policy on fining for market abuse, but it has been reluctant to give much guidance beyond the statutory criteria of:

74 Sections 380 and 381.⇧

75 FSMA 2000, s 381; ENF 6.6. ??⇧

76 Sections 129 and 383.⇧

77 Sections 126, 127, 137 and 392; ENF 15.4.⇧

78 FSA/PN/106/2005, although the two convicted had their prison sentences reduced on appeal.⇧

79 ENF 14.4.⇧

80 (2006) FSMT Case 031, para 344.

– the seriousness of the behaviour's effect on the market;

– whether the behaviour was deliberate or reckless; and

– whether the penalty is being imposed on an individual. [81]

However, for market abuse proceedings, unlike disciplinary actions, the FSA has not said that actions will generally be taken against firms or companies rather than individuals.[82] ⇧

As has already been noted, all the cases so far considered by the FSA's Regulatory Decisions Committee and the Tribunal have been under the old UK provisions. In the two years 2004/05, the FSA fined Shell £17 million for market abuse through issuing misleading oil reserve figures,[83] and fined two finance directors, one financial controller, one company secretary, one head of communications and one auditor for market abuse through insider dealing.[84] One of the finance directors was fined for tipping and the tippee was also fined. Until 2006, the largest insider dealing fine had only been £25,000, (generally two or three times the profit made) but the rate of cases was far higher than prosecutions had ever been under the criminal provisions. In 2006, although the FSA failed to sustain fines of £750,000, £300,000 and £100,000 in *Davidson and Tatham*, fines were upheld against an individual of £250,000 in *Parker* and against a company and an individual of £750,000 each in *Jabre*.

One might assume that in 2006, the FSA was attempting to raise the levels of fines being imposed, perhaps because, as was reported in an Occasional Paper, *Measuring Market Cleanliness*[85], there has been no evidence of any reduction in market misconduct since the FSA acquired its new powers. However, it may have been more a willingness to take on larger more complex cases since, for example, in *Parker*, the fine was still only just over twice the profit for 'as serious a case of market abuse of its kind… as one might imagine'.[86] On the other hand, the FSA's failure in *Davidson and Tatham* was followed by a further defeat over costs where it was held, inter alia, that the penalties that had been sought were unreasonable.[87] *Davidson and Tatham* was unusual in that, although the undisclosed derivatives dealing had helped launch the IPO, the principal dealer lost £4.5 million on the transactions and the market seemed to be largely unaffected.

Whether coincidental or not, there have been no further market abuse cases reported since the costs decision in *Davidson and Tatham* and it could be that the FSA may become more cautious about all but the most straight forward cases of insider dealing or deliberate lying to the market.

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81 Sections 124 and 125; ENF 14.6.2 and 14.7.4.⇧

82 Cf ENF 11.5.1.⇧

83 FSA/PN/074/2004, although no action was taken against any directors or managers, FSA/PN/118/2005.⇧

84 FSA/PN/013/2004, 063/2004, 069/2004, 107/2004, 034/2005 and 141/2005. There are other market abuse cases, but they involved 'offences' by authorised firms.⇧

85 OP 23, FSA March 2006.

86 (2006) FSMT Case 037, p 53.

87 (2006) FSMT Case 040.

Restitutionary Orders

To maintain orderly settlement in the market, the imposition of a fine does not make the transaction void or unenforceable.88 However, for any form of market misconduct, the FSA may:⇧

– apply to the High Court for a restitutionary order against *anyone*; or

– make a restitutionary award itself against any *authorised firm* and, in the case of market abuse against *anyone*, subject to its disciplinary procedures.

The FSA may only pursue such restitutionary claims for accrued profits or losses suffered 'as a result' of the contravention or market abuse on behalf of anyone 'to whom the profits … are attributable; or who has suffered the loss or adverse effect'. There are also reasonable belief and due diligence defences.89⇧

Although the FSA has appeared to seek fines in excess of any profit made (or losses avoided) by market abusers, it has not sought any restitutionary orders, presumably holding to its original view when consulting on these provisions that:

> 'The rationale for the proposed market abuse regime in the UK is … directed at protecting the integrity of market mechanisms, rather than protecting the interests of any particular group of market users … We do not anticipate that the exercise of the FSA's restitution powers would normally be appropriate for the purposes of disgorging profits for the benefit of, for example:⇧
>
> "Contemporaneous traders" – ie persons trading in the market at the same time as persons found to have been insider dealing or misusing information in a manner which constitutes market abuse.⇧
>
> Companies or issuers whose investments have been the subject of manipulation, insider dealing or information misuse.'90⇧

Disciplinary Actions

Given some of the difficulties that market abuse proceedings seem to raise, to avoid proceedings being treated as criminal, the FSA could bring actions for market abuse against authorised persons and approved individuals as breaches of its Principles and Rules (as the SFA did in *Fleurose*) rather than under the specific market abuse provisions. However, in *Fleurose*, Morison J did say:

> 'But after the distinction [between civil and criminal] is drawn, there may be some disciplinary procedures whose characteristics are so akin to criminal proceedings that the concept of fairness requires more or less the same protections in both.'91

88 Section 131.⇧

89 Sections 382(1) and (8), 383(1), (3) and (10) and 384(1) and (6). Market abuse again includes indirect market abuse through requiring or encouraging others to engage in actions. The Secretary of State can not seek remedial orders for insider dealing or market abuse.⇧

90 Consultation Paper 17, paras 155 and 158; ENF 9.6.⇧

91 [2001] IRLR 764, para 52

Certainly the European Court of Human Rights took the view in *Albert & Le Compte v Belgium*[92] that in disciplinary procedures, the protections of a clear charge, time to prepare a defence and the right to call and cross-examine witnesses applied even if the proceedings were civil. In *Fleurose*, the issues were the vagueness of the FSA's Principles, the right to legal representation, and the privilege against self-incrimination.

On the issue of vagueness, Morison J maintained that this was common with provisions against professional misconduct, was perfectly acceptable and presumably will remain so under the new regime. On legal representation, he pointed out that the European Court of Human Rights had only ever required this for courts, not tribunals. On the protection from self-incrimination, he dismissed it as inappropriate when protecting the public.[93] The Court of Appeal agreed but was not quite so sweeping, pointing out that Fleurose knew in detail the complaint against him, had had representation at most of the stages and strictly speaking had never been compelled to give evidence.[94]

Still, in *Davidson and Tatham* and in *Jabre*, cases were brought against the approved individuals involved for breaches of the FSA's Statement of Principles for Approved Persons[95] as well as for market abuse. Interestingly, in *Davidson and Tatham*, the stockbroker involved (an approved individual) did not refer his £100,000 fine for market abuse and breach of the Principles to the FSMT. However, when the FSMT dismissed the case against the others, the FSA voluntarily withdrew the fine against the stockbroker.[96] Another interesting case showing that the Principles for Approved Persons may be easier to use than market abuse provisions is the fine of £10,000 on Pignatelli for not considering and reporting that an email received might have contained inside information, even though it was later determined that it did not.[97]

Again, the use of information 'not in the public domain', though not necessarily inside information, featured in the fining of the authorised stockbroking firm of Hoodless Brennan for breach of the FSA's Principles for Business;[98] and in *Jabre* the authorised hedge fund that profited from Mr Jabre's behaviour was fined £750,000 for market abuse and for breach of the Principles for Business, because it failed to control Mr Jabre. The most dramatic use so far of the Principles against an authorised firm instead of market abuse has been where Deutsche Bank AG was fined £6.4 million for misleading non-transparent trading while book-building (not unlike *Davidson and Tatham*, but here no market abuse proceedings brought).[99]

It is apparent that proceedings for breach of FSA Principles seem to be easier than market abuse proceedings, though this could be for a combination of at least reasons:

92 [1983] 5 EHHR 533.

93 [2001] IRLR 764, paras 59 to 66.

94 [2002] IRLR 297, CA, paras 16 to 24..

95 APER 2.

96 FSA Statement, July 2006.

97 FSA/PN/122/2006.

98 FSA/PN/079/2006; PRIN 2.

99 FSA/PN/036/2006.

1. the width of the Principles leaves much more to the FSA's discretion and that is hard to challenge because these, unlike market abuse proceedings, are civil in nature; and
2. authorised firms and approved individuals, unless they are in danger of losing their status, are less likely to fight FSA fines as they have to keep on the right side of their continuing regulator.

Part 6 Proceedings

As the Prospectus, Market Abuse and Transparency Directives have been implemented, Part 6 of the FSMA has become one of the most amended parts of that legislation. Throughout, however, UK listed companies (but not AIM or Plus Market companies) have been subject to a general disclosure obligation to announce inside information as soon as possible.[100] As omissions can amount to market abuse, failure to comply with this obligation could be treated as market abuse, just as the inaccurate announcement in the Shell case was. However, delays in announcing price-sensitive information have generally been pursued as breaches of the Part 6 rules rather than market abuse and FSMA, s 91 gives the FSA the power to publicly censure and impose fines for breach of these rules.

In the two years 2004/05, the FSA fined three companies, censured two companies and fined two chief executives for breach of Part 6 rules through delaying the announcement of bad news.[101] The highest fine on a company was £450,000 and on an individual, £45,000. There does not, however, seem to have been a case since then and it may be that these examples have been enough to make all listed companies and their directors very conscious of their duty to keep the market informed of any significant

developments.⇧

The Stock Exchange imposes a similar disclosure obligation on AIM companies and has similar sanctions for breach.[102] Although the Stock Exchange has privately censured a number of AIM companies for such a breach, it has never fined one, nor has it publicly censured one since 2004.

Conclusion

If market abuse proceedings by themselves were supposed to 'fill the gap' in the protection of financial markets, the first five years have probably been something of a disappointment. However, taken with the other weapons at the FSA's disposal, the picture is not so bleak. Nevertheless, for anyone hoping that the creation of civil actions in the hands of a single financial regulator would make a dramatic difference to the war on market misconduct, the results must so far have been rather disappointing. Most of those fined have been relatively small fry in reasonably straightforward cases. Only when dealing with authorized firms and approved individuals within the regulated sector or one or two listed companies has the FSA really been able to push the boundaries of action beyond what could have been caught under the old criminal provisions.

The change in the scope of market abuse and of the FSA's Code with the implementation of the MA Directive seems unlikely to change the regulator's approach,

100 Currently DTR 2.2.

101 FSA/PN/029/2004, 040/2005, 010/2005, 080/2005 and 133/2005.

102 AIM rules 10, 11 and 42.

and the fact that there have yet to be any cases under the new provisions only highlights how slow cases are under the FSMA procedures.

On the other hand, for those like myself, who feared that the FSA might face political pressure to use its new powers in an overly aggressive and indiscriminate manner, the first five years have proved rather consoling. Although the drafting of the statutory provisions and the Code may no longer be quite as clear since the MA Directive as before, there is no reason to suppose that the FSA will abandon its generally fairly cautious approach to using market abuse proceedings in the next five years.

Professor Alistair Alcock, Founding Head of the Salford Law School