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'Market Abuse' Concept Under UK Law

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This article deals with the Market Abuse concept, which is acclaimed for playing a pivotal role on the regulated market. This doctrine is to be viewed within the UK and EU frameworks. Furthermore, the main point of this article is to provide the reader with comprehension of the ramifications of evolving financial offenses. The article goes through the position of insider dealing, which is a criminal offense under UK law. Market manipulation, including misleading information and misrepresentation, influences the price of shares. Finally, the concept of ad hoc disclosure will be discussed. Also, rules and consequences under Financial Service and Markets Act 2000 and Criminal Justice Act 1993 will be discussed. The article amalgametes the UK and EU views, which provide different points and punishments.

Keywords: *Insider trading, market abuse, shareholders, stakeholders, primary insider, secondary insider, Criminal conviction, financial offense, market integrity, Market manipulation, ad hoc publicity, price-sensitive information.*

Introduction

In recent years, market abuse has become an extremely important issue within the UK and EU. Occasionally, different parties dealing in finance abuse the financial sector. In order to maintain the market integrity and prevent financial offenses, legislation has been implemented. These enactments are deemed to be an important part of the ongoing regulation of the capital market. The market abuse concept will be considered in light of the UK and EU legislation and case law. In the EU, at the first level, the Market Abuse Directive 2003/6/EC provides the fundamental principles and basic legal framework. At the second level, Directive 2003/124/EC and Regulation (EC) No 2273/2003 provide some technical issues. At the third level, the Committee of European Securities Regulations (CESR) publishes guidance on the common operation of the Directive. Finally, the Commission ensures compliance with European law.[1]

Furthermore, this paper will consider the market abuse concept in light of UK law. There are three different market abuse offenses to be considered in this essay: the Criminal offenses of insider dealing under the Criminal and Justice Act of 1993;[2] offenses of market abuse under Section 118 of the FSMA; and market manipulation offenses under Section 397 of the FSMA.[3] Also, some issues will be considered in accordance with the Disclosure and

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[1] Siems (2008) p. 49

[2] Criminal Justice Act 1993. p. 14. (hereinafter, The Act).

[3] Financial Services and Markets Act 2000, at p. 19.

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Transparency Rules.[1] This article aims to analyze one of those market abuse concepts—insider dealing.

Method and Methodology

The main sources for writing this article included the official documents of the EU, the US, the UK, case law, and academic sources. The study used the basis methods of cognition: the critical analysis and systemic, and the method of comparative law. The author's arguments are based on a critical analysis approach. The method of comparative law defines the views on actual international and domestic legal rules on market abuse liabilities. A systematic method achieves a variety of disciplines (criminal law, international law, financial law, and securities law), and is accessible and comparable, as present is determined by the past and the future—by the present and the past.

Insider Dealing

The primary purpose of insider dealing and market manipulation regulations is to protect investors. Capital market regulation requires investors to obtain correct and timely information in order to make an accurate decision regarding company shares.[2] The Act points out two types of insiders, "primary" and "secondary." Although the definitions of "primary insider" and "secondary insider" are not found in the legislation, the House of Lords elaborated and endorsed them in *AG's Ref*.[3] A "primary insider" is a person who obtains information by being a director, employee, or shareholder of the company, or who can be a professional employee, such as an advisor of the company or a lawyer. A "secondary insider," on the other hand, is the person who obtains the information from the primary insiders.[4] For instance, a secondary insider may be the wife of the primary insider, who provides her with information regarding company affairs. Due to the nature of the criminal offense, it is not sufficient for an individual to merely possess the information, but that individual must also know that it is inside information, and that he has obtained it from an inside source. According to the Act, a person is not defined as an insider if he possesses information; instead, he must demonstrate the nature and reference of the information.[5] However, the definition of inside information is key within the Criminal Act.

In accordance with the Act, inside information should be related to particular securities or to the particular issuer of the securities.[6] It can be

[1]Disclosure and Transparency Rules, DTR 2, p. 3.
[2]*Id.* at p. 30.
[3]AG's Ref (No 1 of 1988) [1989] 1 AC 971. P. 10.
[4]Criminal Justice Act 1993 § 57b.
[5] *Id.* At p. 37.
[6] *Id.* at § 56(1)(a).

understood by a simple example of an imminent takeover bid. The information relating to the acquisition is frequently regarded as inside information that might influence the business and the price of shares, which will have an impact on the takeover.[1] However, information relating to the market sector in which a company operates in is not considered inside information. Furthermore, the information should be precise or specific.[2] For instance, specific information may be regarded when a company has exceeded in profit, but the actual amount is not known. The information is indeed precise when the amount is known.[3]

According to the Act, an "individual who has information as an insider" is guilty of inside dealing in three different circumstances, which will be considered further. The first circumstance is the offense of actual dealing in securities, where an individual must have inside information as an insider and must deal with it in the regulated market, or they can use a professional intermediary or deal as a professional intermediary, themselves. Under that provision, an insider must acquire and dispose of securities on the regulated market. An individual must deal with securities that price-affected the inside information. However, it should be pointed out that possessing the information is not considered an inside dealing.[4] Due to the fact that, in the UK, it is a criminal offense, the *mens rea* element must be proven. The insider must know that the information he possesses is inside information. However, it is rather complicated to establish those facts for the prosecution. For the purpose of this paper, it should be noted that there are various remedies available. For instance, "[a]n individual should demonstrate that he would have done what he did even if he had not had that information."[5] It seems logical, as it prevents individuals from unfair trial. Another example is if an individual demonstrated that he believed that the information had been widely disclosed to ensure that none of those who took part were insiders.

The second offense under the Act is offense of encouraging another person to deal. The Act set out that an individual who has inside information and encourages another person to deal in the price-affected securities in relation to that information is criminally liable.[6] However, the dealing need not actually take place. It is enough if an individual has reasonable cause to believe that the dealing would be prohibited. Moreover, the other person neither needs to know that the securities are price-affected, nor that the information is inside information. It is also established that the required *mens rea* for this offence is that an individual must know or have reasonable cause to believe that the price affected securities would be dealt on a regulated market, or demonstrate reliance on the intermediary.[7] Curiously, the remedies for this offense are the same as the remedies for actual dealing.

The third offense under the Act is the offense of disclosing inside

[1] *Id.* at § 60(4).
[2] *Id.* at § 56(1)(b).
[3] Gullifer and Payne (2011) p. 120.
[4] Criminal Justice Act 1993 § 56.
[5] *Id.* at § 53(1)(b).
[6] *Id.* at § 52(2)(a).
[7] *Id.* at § 53.

information to another person. Again, an individual must know that the information is inside information and that he has obtained it from the inside source and disclosed it to another person in the proper performance of the employment function.[1] The defense for such an offense is to demonstrate that the individual did not expect the person to whom the information was disclosed to deal on regulated market.[2]

The offenses seem to be implicitly clear; however the penalties and enforcement of those offenses must be established. Due to the criminal nature of inside dealing, it is rather difficult for the prosecution to determine the *mens rea*. However, the FSA shed light on the penalty and added a special element into prosecution of the offense, even though the judge and the jury are non-specialist. FSA secured the first criminal case in March 2009, and numerous prosecutors followed it. A lawyer, employed by TTP Company, obtained information that a company was about to be taken over. He tipped off his father-in-law to buy shares in the company. As soon as the takeover had been completed, the price of the shares had risen to 49,000 pounds. Both the lawyer and his father-in-law were convicted for eight months and twelve months, respectively.[3] This crime was the first financial crime under the FSA.

However, the criminal inside dealing offenses discussed above are hardly enforced because of the need to demonstrate the *mens rea* and satisfy high standards. As a result, in 2000, a new offense of the market abuse was introduced in Section 118 of the FSMA, which substitutes administrative sanctions for criminal sanctions. Moreover, the Act was amended in the Market Abuse Directive in 2005.[4] This essay will not examine the offenses of inside dealing under the FSMA due to limitations, but it will further scrutinize the EU legislation. The EU Directive set out almost the same definition of insider and also set out four requirements.[5] First, the information should be precise, whereas the Criminal Act of 1993 required that information should be precise or specific. Second, the information has to be non-public. Third, the information should be related, directly or indirectly, to the securities, issuer, or financial instrument. The last requirement is that the information should be price-sensitive. Also, the Directive defined primary and secondary insiders similar to the 1993 Act.

Market Manipulation

Market manipulation is believed to be the most complicated type of the market abuse concept. However, European legislation does not provide a clear definition. Its purpose can be understood by some basic examples, such as prohibition of the securities fraud. Information for investors should be clear

[1] *Id.* at § 52(2)(b).
[2] R v Goodman [1993] 2 AII ER 789. p. 2.
[3] R v McQuoid [2009] EWCA Crim 1301; [2009] 4 AII ER 388. p. 12.
[4] Market Abuse Directive 2003/6/EC. p. 24.
[5] *Id.* at p. 11.

concerning the price in order to avoid misleading and fraud.[1] Also, the Market Abuse Directive illustrates other types of market manipulation such as "false or misleading information," which covers straightforward situations; "false, or misleading transactions;" "Transactions involving deceptions;" and "price positioning." Therefore, it can be complicated to distinguish "false or misleading transactions," and "transactions involving deception." Therefore, Professor Siems shed light on the distinction, commenting on the Directive: "[t]hey are defined as 'transactions or orders to trade which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments' and 'transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.'"[2]

The complexity of the context of market manipulation implicitly attracts researchers, although manipulation by "price positioning" is the most complex because it includes the dominant position of securities, options, futures, and other derivative instruments.[3]However, due to limitations, this essay will not scrutinize the Directive deeper, but will examine the situation in the UK

With regards to the UK, two sections of the FSMA exist that regulate market manipulation: Section 397 and Section 118.[4] Due to the constant appearance of new schemes in market manipulation, the definition of the concept is not straightforward.[5]However, the concept of market manipulation can be understood by unwarranted interference in the price-forming mechanism.[6] As an example can be used a dissemination of rumor concerning takeover bid. This leads to misleading information, which may induce investors to buy shares. The main distinction between the sections is the criminal nature of Section 397, which requires showing the *mens rea* element for the offense.[7] As for the criminal emphasis of the essay, it is going to scrutinize Section 397 of the FSMA deeper.

The first offense under Section 397 is "Misleading Statement and Dishonest Concealment." A defendant will be liable under this section as long as "he makes a misleading information, forecast or profit, which he knows to be false, misleading or deceptive in a material particular or reckless in that regard."[8] The requirement of knowledge here includes obvious knowledge and willful blindness. It can be understood by looking at a basic example, such as misleading advice given by a broker in order to promote the sales of shares, which make up a market. The earliest case of market manipulation happened in France where a Dover French officer conspired with De Berenger to report

[1]Gilson and Kraakman (2003) p. 121.
[2]Directive 2003/124/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, art. 1(2)(s1)(a), (b), OJ. L 339/70. 24.12.2003.
[3] *Id.* at art. 1(2)(s2).
[4] Financial Services and Markets Act 2000 § 397.
[5] Lomnicka (2001) p. 270.
[6] Gullifer and Payne (2011) p. 340.
[7] *Id.* at p. 345.
[8] Financial Services and Markets Act 2000 § 397.

false information regarding Napoleon's death.[1] The information led city stockbrokers to buy the government's debts, which induced the price to rise dramatically high. Therefore, Section 397 requires the statement to be made in a misleading manner, and that the defendant should foresee the ramifications. The investors, to whom the statement or concealment is made, should invest on the basis of that statement. However, the consequences need not necessarily occur, as long as a misleading statement is made and the defendant actually intends the consequences.[2] A good example is the case, *R v Bailey and Rigby*, where chief executive and chief financial officers were convicted of issuing misleading statements, which pushed the price of shares and induced investors to buy. They received custodial sentences of eighteen and nine month respectively.[3]

The second offense under this section is "Misleading Practice and Conduct." A defendant will be found liable under this section if he acts or creates an impression as to the market for the purpose of upsurging the price of shares, which leads investors to decide whether to buy or dispose shares. The difference between the offenses, is that for the second one, it is enough to demonstrate that a defendant intended to create an impression, whether intentionally or recklessly.[4]

The criminal nature of the offense has proven to be difficult to prosecute. However, Section 118 moves away from criminal nature and treats offenses slightly differently. Furthermore, the section allocates the market manipulation into four types. The first type consists of effecting transactions or orders to trade.[5] The second type is effecting transactions that employ fictitious devices. The third type is the transactions, which include disseminating information, which is likely to give a false or misleading impression, as to the qualifying investors.[6] Curiously, Section 397 requires *mens rea* for this offense, whereas Section 118 moves away from intent towards a more effect-based. The fourth type of offense under Section 118 includes the regular use of misleading information or a regular user of the market that would distort the market.[7] The main distinction between sections, as pointed out above, is consideration of the results, rather than the actor's intent, as part of the offense. From the above analysis of market manipulation, it can be pointed out that this offense is the most complicated in the market abuse concept, considering its criminal nature and difficulties in enforcement.

[1] R v De Berneger [1814] 3 M & S 67; 105 Eng Rep 536. p. 4.
[2] R v Lockwood [1987] 3 BCC 333, p. 3.
[3] R v Bailey and Rigby [2006] 2 Cr App R (S) 36, p. 5.
[4] Directive 2003/124/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, § 118, OJ. L 339/70. 24.12.2003.
[5] *Id.* at § 118(5).
[6] *Id.* at § 118(6).
[7] *Id.* at § 118(8).

Ad Hoc Publicity

The third type of market abuse concept is ad hoc publicity. The meaning of ad hoc is "for this purpose only." This offense seems to be slightly different from the offenses discussed above, as it directly concerns the issuer, whereas market manipulation and insider dealing may indirectly concern the issuer or financial instrument.[1] This seems logical, as it is not the issuer's responsibility to disclose information to the public regarding decisions of the central bank, tax rates, takeover bids, and others. However, in accordance with CESR guidance, the issuer has to keep such information confidential in order to avoid insider dealing. Additionally, the original legislation on ad hoc disclosure is found in the Market Abuse Directive, and also in the EU Transparency Directive, which deals with periodic financial reporting.[2]

In addition to periodic reports, listed companies in the UK must disclose certain information. In this section, the essay will consider two types of ad hoc disclosure: inside information, and directors' shareholdings.[3]

The requirements for disclosure of inside information is found in the Market Abuse Directive, which implements UK law via the FSA's Disclosure and Transparency rules.[4] The idea is to disclose the information as soon as possible via the Regulated Information Service (RIS). As an example, it may be used for disclosure of discussions related to a takeover bid or other inside information related to the company or its securities. One possible purpose of such disclosures is to make investors aware of the information, which may impact their decision to buy shares or not. Perhaps the most serious disadvantage of this method is that the company may publish misleading information, or not even disclose it publicly, which, implicitly influences investors' decisions.

There has long been a requirement in UK law that directors of a company have to demonstrate their interest. The current rules are set out in the Market Abuse Directive, which states that directors must demonstrate their interest in the company and their dealings in shares or other financial instruments of the issuer.[5] The aim of this disclosure is corporate governance-focused. The disclosure of directors' information improves company performance and is a part of the monitoring of the directors' stewardship. The problem with this approach is that it fails to prevent disclosure of misleading or false information regarding a director's interest. It may be shown in order to display the company's stability or influence the share price for purposes of profit maximization.

[1] Siems (2008) p. 49.
[2] Disclosure and Transparency Rules, DTR 2. art. 35.
[3] Gullifer and Payne (2011) p. 380.
[4] Disclosure and Transparency Rules, DTR 2. p. 4.
[5] Market Abuse Directive 2003/6/EC. p. 32.

Results

As seen above, the Market Abuse concept is a sensitive issue in the regulated market. Many countries do not implement the regulations for such offenses, which negatively influences the internal evolution of the economy and the law itself. This research provides the grounds for the expansion of the Directive 2003/6/EC and for the development of internal regulations.

Conclusion

In conclusion, it would not be an exaggeration to say that there is a comprehensive field to conduct deeper study of the concept of market abuse. However, as can be implicitly seen, current legislation attempts to deal with such offenses as inside dealing, market manipulation, and ad hoc disclosure. As discussed above, UK legislation has allocated some offenses to the criminal nature. The vast majority of criticism of the prosecution of such offenses is that it is hard to prove the *mens rea* element. This essay, however, identified that, regardless of difficulties in prosecution, case law has developed applicable precedents.

There is no doubt that the mechanism of market abuse is comprehensive, and new ways to breach the law appear every day. However, it seems that the FSA rules are updated constantly, thereby inducing the market to maintain its integrity. The question, therefore, that needs to be answered is whether the market abuse concept protects investors or shareholders, or even the market's integrity. It seems that as long as there is deep scrutiny of the concept, the answer might be that it protects all of them. Shareholders are protected from fraud and cheating by the company, whereas investors, relying on information about a company, which is deemed to be trustworthy, are able to make their decisions more safely. Therefore, in order to fully answer this question, deeper analysis is needed.

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