

*MARKET ABUSE – Effect of Code – Actuating purpose – Preliminary issue -  
Whether necessary to have actuating purpose to mislead or distort the market – No  
– References dismissed – FSMT 2000 s.118(2)(b) and (c)*

**FINANCIAL SERVICES AND MARKETS TRIBUNAL**

**(1) WINTERFLOOD SECURITIES LIMITED  
(2) STEPHEN SOTIRIOU  
(3) JASON ROBINS**

**Applicants**

**- and -**

**FINANCIAL SERVICES AUTHORITY**

**The Authority**

**Tribunal: SIR STEPHEN OLIVER QC  
TERENCE MOWSCHENSON QC**

**Sitting in public in London on 11 March 2009**

**Charles Flint QC and Javan Herberg, instructed by Ashurst LLP, for the Applicants**

**Bankim Thanki QC, Michael Green and Katherine Watt, for the Authority**

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## DECISION

### *Introduction*

- 5 1. These consolidated References referred to the Tribunal on 17 July 2008 concern the Applicants' trading of shares in Fundamental-E Investments plc ("FEI") on the Alternative Investment Market ("AIM") between September 2003 and July 2004. Following an investigation and warning notices, and an oral representations meeting before the Regulatory Decisions Committee
- 10 ("the RDC") of the Financial Services Authority ("the FSA"), on 19 June 2008 the RDC issued decision notices finding that all three Applicants had engaged in market abuse within the meaning of section 118 of the Financial Services and Markets Act 2000 ("FSMA"), and imposed financial penalties of £4 million on the First Applicant ("Winterflood"), £200,000 on the Second Applicant ("Mr Sotiriou") and £75,000 (reduced to £50,000 on the grounds of personal financial circumstances) on the Third Applicant ("Mr Robins").
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2. On 22 January 2009 the Tribunal ordered that two issues be tried as preliminary issues in the consolidated References and that the hearing of the preliminary issues be treated as the hearing of the References pursuant to Rule 13(2) of the Tribunal Rules, on the basis that the determination of the two preliminary issues substantially disposed of the Reference, given the parties' agreement that neither would seek to pursue further issues (subject to the possibility of an appeal) in the light of the decision on the preliminary issues. Accordingly, it is common ground that the Tribunal should either allow the References, directing the Authority to take no action in respect of the matters referred, or (if it finds against the Applicants) dismiss the References, directing the Authority to take the action set out in the Decision Notices, according to its findings on the preliminary questions.
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- 30 3. Messrs Sotiriou and Robins took no part at the hearing of the preliminary issue, but they supported and adopted the submissions of Winterflood. They have agreed to be bound by the decision of the Tribunal.
- 35 4. Market abuse is defined in section 118 FSMA. At the material times, the relevant provisions were in the following terms:
- "118(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly in concert):
- 40 (a) which occurs in relation to qualifying investments traded on a market to which this section applies;
- (b) which satisfies any one or more of the conditions set out in subsection (2); and
- (c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a

failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.

5                   118(2)    The conditions are that:

(a)

.....

10                   (b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question;

15                   (c) a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.

...

118 (10) “regular user”, in relation to a particular market, means a reasonable person who regularly deals on that market in investments of the kind in question.”

20    5.    For the purposes of these preliminary issues there is no dispute between the parties that the Applicants’ behaviour could fall within the conditions of section 118 FSMA, so that looking solely at the definition set out in that section that behaviour could fulfil the criteria of market abuse. However, the Applicants contend that merely satisfying the statutory definition of market  
25    abuse is not sufficient and that it is necessary for the Authority to prove some form of subjective mental element on the part of the Applicants to mislead or distort the market. This requirement, they claim, is imposed by the Code of Market Conduct (“the Code”) which has been issued by the Authority pursuant to section 119 FSMA and must be read into the statutory definition.

30    6.    The Authority’s position is that market abuse within the meaning of section 118 is behaviour that satisfies the statutory definition contained in section 118. So far as material to these references the Code merely provides non-exhaustive guidance as to the sorts of behaviour that the Authority considers  
35    would amount to market abuse within the meaning of s.118. The principal issue for determination by this Tribunal is which of those positions is correct. This is to be determined by the determination of the issues (set out below) directed to be heard by the Directions published on 22 January 2009.

40    7.    The preliminary issues are questions of law. They are:  
(a)    In order for Winterflood to have committed market abuse under section 118(2)(b) or 118(2)(c) of FSMA on the basis set out in the

Statement of Case, was it necessary for them to have an actuating purpose (as defined in the Code) to mislead or distort the market? (“the Actuating Purpose Issue”) and

5 (b) If the Tribunal finds that in order for Winterflood to have committed  
market abuse under section 118(2)(b) or 118(2)(c) FSMA it was  
necessary for it to have acted “recklessly” or more than “grossly  
negligently”, is it permissible for the Authority to put forward the  
allegations of recklessness against Winterflood as set out in the  
10 Statement of Case at paragraphs 53.3, 54.3, 56 and 57 (“the Fresh  
Allegation Issue”).

8. The Actuating Purpose Issue is in the nature of a preliminary issue of law. If  
it is a necessary ingredient of market abuse that the Applicants have an  
15 “actuating purpose” to mislead or distort the market then the Authority has  
accepted that its case on this Reference cannot succeed. On the other hand, if  
an actuating purpose is not necessary to establish market abuse in this context,  
then (subject to the Fresh Allegation Issue, below) the Applicants have  
accepted that they would not pursue the reference further.

20 9. On Winterflood’s case the Fresh Allegation Issue does not arise; the Actuating  
Purpose Issue will resolve the reference one way or the other. There is no case  
pleaded by the Authority in its Statement of Case that the requirement to  
prove an actuating purpose, if there is such a requirement, may be met by an  
25 allegation of recklessness. The further issue arises only if the Tribunal were to  
find that market abuse requires an actuating purpose, but that an actuating  
purpose may be established by proving “recklessness”. In that eventuality, the  
Applicants contend a second issue of law could arise. They contend that the  
Authority is not entitled to allege in its case to the Tribunal, and the Tribunal  
30 is not entitled to find, that the Applicants acted recklessly because such a case  
was advanced to the RDC by the Authority but was not adopted by the RDC  
and was not embodied in the Decision Notices. The Applicants reserved their  
position as to whether it is permissible under the FSMA, and as a matter of  
due process, for the Authority to advance a case on a Reference which was not  
35 part of the decision notice being referred. We heard no argument on the  
second issue although the issue was referred to in the skeleton arguments.

### ***Factual Background***

40 10. The background to the References is set out in the respective skeleton  
arguments. It was accepted that the Tribunal had to approach the matter on  
the basis that the facts set out in the Statement of Case were correct and we  
emphasise that we make no determination of the facts. For convenience we  
take the description of the background facts from the Authority’s skeleton  
45 argument.

11. Winterflood is a London-based market-maker specialising in smaller company  
securities, including those listed on AIM. Winterflood provided a market

making service in the shares of FEI which were traded on AIM. At the material times, Mr Sotiriou and Mr Robins were market-makers employed by Winterflood, and were responsible for Winterflood's market making activities in relation to FEI until 3 February 2004, and between 3 February 2004 and 15 July 2004, respectively.

### **The FEI share ramping scheme**

12. The relevant history of this matter starts in May 2003. As at that date, 85% of the issued share capital of FEI (140 million shares) was owned by two shareholders (“the original shareholders”), and there was little or no market demand for FEI shares. However, a Mr Simon Eagle was seeking to secure control of an AIM shell company as an investment vehicle to acquire electronic technology companies, and Mr Eagle identified FEI as suitable for this purpose. In May 2003, therefore, Mr Eagle agreed with the original shareholders to arrange for their shares to be sold, and in July 2003, he arranged with Winterflood that the original shareholders would approach Winterflood to sell their shares, and that Mr Eagle would then buy the stock from Winterflood.
13. Mr Eagle thereafter instituted a share ramping scheme in FEI shares, the effect of which was to inflate the share price of FEI shares from around 2.5p as at May 2003, to 4.13p by the end of December 2003, and to a high of 11.75p by 5 July 2004. It is the behaviour of Winterflood, Mr Sotiriou and Mr Robins in relation to the share ramping scheme that the Authority contends amounted to market abuse.
14. The key elements of the share ramping scheme were as follows.
- (a) *Acquisition of SP Bell:* Mr Eagle proposed to buy a 10% stake in FEI himself but had to find buyers for the remaining 75%. To do so, he needed to generate significant demand for its shares. On 27 May 2003, Mr Eagle acquired SP Bell Limited (“SP Bell”), an agency-only stockbroking firm, using an investment vehicle. Mr Eagle intended to find buyers for the remaining 75% of FEI shares and to maintain demand thereafter by, for the most part, selling to clients of SP Bell.
- (b) *Rollover trades and delayed rollover trades:*
- i. In order to procure sufficient purchasers for the 85% interest of the original shareholders, and to continue to buy FEI shares in the market following the initial sale, Mr Eagle introduced 50 new clients to SP Bell in the period from 18 July 2003 to 13 May 2004 (“the Eagle clients”). However, a number of the Eagle clients did not have sufficient funds to pay for the shares, so in order to avoid those clients being required to make payment, Mr Eagle instituted a scheme whereby their FEI positions were purportedly rolled from one SP Bell client to another. Specifically, SP Bell bought FEI shares for the

5 account of a client on credit from a market maker, typically on a T+10 settlement basis, and then sold those shares via the market maker to the account of another client at or before the date of settlement, typically on a T+2 settlement basis. A rise in share price during the intervening period covered the cost of purchase, and also left an apparent profit on the first account that could be used to purchase more FEI shares.

10 ii. From 5 January 2004, Mr Eagle refined the rollover scheme by the use of delayed rollover trades, whereby the size and price of the buy and sell legs of the rollover trade were agreed at the outset, but the two legs of the transaction were then executed at different times of day.

15 iii. The effect of the rollover scheme was to defer settlement, potentially indefinitely. However, it required a rising share price in order to operate successfully.

20 (c) *Consistent purchasing of FEI shares by SP Bell:* In order to support and increase the FEI share price, SP Bell consistently purchased FEI shares (in particular, from Winterflood), regardless of market conditions. In many cases, this trading was not authorised by the underlying clients, and shares bought were not paid for but were simply added into the rollover scheme. The trading did not represent genuine market demand for the shares.

25 (d) *Involvement of Winterflood:* The involvement of Winterflood, Mr Sotiriou and Mr Robins was critical to the success of the share ramping scheme. In particular:

30 i. Between August and December 2003, Winterflood sold the 140 million FEI shares of the original shareholders. Over 80% were sold to SP Bell; less than 5% were sold in the course of its normal market making business. Winterflood's intermediation of the sales allowed Mr Eagle to obscure the full extent of his financial interest and involvement in the FEI share sales, and in particular the significant commission he stood to earn from the vendors, from the employees and clients of SP Bell and the market generally.

35 ii. The rollover scheme required the involvement of a market maker. Winterflood executed all of the rollover trades entered into on behalf of the Eagle clients, and most of the delayed rollover trades. The number of such trades was extremely high: 40 30 rollovers in the course of the initial sale of shares between 24 September and 31 December 2003; 239 rollovers between January and July 2004; and 27 delayed rollovers between 5 January and 18 March 2004.

- 5                   iii. The relationship between Mr Eagle and Winterflood, and between Mr Eagle and Mr Sotiriou in particular, was unusually close. There was obvious and frequent pre-arranging of trades, whereby Winterflood traders spoke first to Mr Eagle on an untaped line and then conducted the trade with SP Bell on a taped line, and SP Bell brokers were instructed by Mr Eagle to deal only with Winterflood when trading FEI shares. The level of communication on untaped lines between Mr Eagle and Mr Sotiriou in particular was unusually high.

10                   **The effect of the FEI share ramping scheme on the market**

- 15                   15. The FEI share ramping scheme had the effect of misleading the market as to the supply, price or value of and demand for FEI shares and of distorting the market in FEI shares. It caused the positioning of the FEI share price at an artificially high level, and resulted in an almost five-fold increase in the share price of FEI between May 2003 and July 2004 (as set out in paragraph 13 above). This is clearly illustrated by the chart at paragraph 36 of the Authority's Statement of Case, which shows the movement in the price of FEI shares and the volume of shares traded by SP Bell, by all other firms and in total, between 2 January and 15 July 2004.
- 20                   16. On 15 July 2004, the share price of FEI fell sharply from 11.75p to 7.5p as a result of sustained selling. The London Stock Exchange also received information that substantial unsettled positions in FEI shares had accumulated within SP Bell. At 10.35am, the Exchange temporarily suspended trading in FEI shares because it was of the view that the market was disorderly. The suspension of trading caused the unsettled positions in FEI shares at SP Bell to crystallise. Neither the clients of SP Bell nor SP Bell itself had sufficient funds to settle the resulting debt of over £9 million.
- 25                   17. On 23 July 2004, SP Bell ceased trading and was placed into administration. Trading in FEI resumed the same day: the price of FEI shares fell to 4p by close of business and continued to fall steadily thereafter.
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**Involvement of Winterflood, Mr Sotiriou and Mr Robins in the share ramping scheme**

- 35                   18. FEI was the single most profitable stock for each of Winterflood, Mr Sotiriou and Mr Robins. Winterflood received £204,403 from the sale of the interest of the original shareholders and approximately £941,133 from its trading in FEI shares between January and July 2004. The profitability of trading in FEI had a direct impact on the level of bonus awarded to Mr Sotiriou and Mr Robins.
- 40                   19. However, that profitability was achieved by means of behaviour by Winterflood, Mr Sotiriou and Mr Robins that fell squarely within the provisions of section 118 FSMA, because their behaviour, in particular their

behaviour in executing rollover trades, executing delayed rollover trades and consistently selling FEI shares to SP Bell, was (among other matters):

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- (a) likely to give a regular user of the market a false or misleading impression as to the supply of, demand for, price or value of, FEI shares; and/or
- (b) such that a regular user of the market would, or would be likely to, regard the behaviour as that which would, or would be likely to, distort the market in FEI shares; and
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- (c) likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of Winterflood, Mr Sotiriou and Mr Robins respectively to observe the standard of behaviour reasonably expected of persons in their position in relation to the market.
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20. The reasons why their behaviour was likely to give a false or misleading impression and/or to distort the market and fell short of the standard reasonably to be expected are set out in detail in the Authority's Statement of Case, but are in summary as follows.
21. *False or misleading impression and/or distortion of the market: section 118(2)(b) and (c) conditions*
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- (a) *Execution of rollover trades:* The volume of rollover trades (which were not genuine transactions) was 84% of the volume of FEI trades reported by all firms between January and July 2004. This amounted to approximately 10 times the issued share capital of FEI. However, as rollovers are reported to the market as separate transactions, the fact that these trades were rollovers would not necessarily be apparent to a regular user as such; in particular, that fact would not be apparent where a number of shares were used to book the total size of one or both legs of the rollover. Execution of the rollovers thus gave an impression of substantial and continuous demand for FEI shares that did not in fact exist. Moreover, even if a regular user were to interpret any of the rollover trades as such, the regular user would assume (erroneously) that the trades were individual, short term rollovers following which the trade was settled. In fact, the rollovers were in breach of Exchange Rule 3050, which (in order to ensure that trades are settled promptly) prohibits rolling over a position in a security more than once, and the rollover scheme concealed from the market the fact that a significant number of FEI shares had not been paid for. Had the market known this, it is highly likely that the FEI share price would have fallen significantly.
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- (b) *Execution of delayed rollover trades:* Delayed rollovers are even more misleading, because the time lapse between the execution of the

two legs of the trade makes it impossible for a regular user to identify the trades as rollovers with any degree of certainty – and this is compounded where the delayed rollover is asymmetrical and is thus reported as unmatched multiple transactions. Delayed rollovers are also rare. The volume of delayed rollovers was extremely high – 27 delayed rollovers in the space of 2½ months, representing 40.5% of the volume (almost 190.4 million shares) of FEI trades reported by all firms in this period. This was equivalent to the entire issued share capital of FEI. Moreover, the delayed rollovers were consistently transacted at the top end of the touch price, and only seven were completely symmetrical. Execution of the delayed rollovers thus gave an impression of substantial and continuous demand for FEI shares that did not in fact exist, and, further, that such demand was at higher prices when this was not in fact the case.

(c) *Consistent selling to SP Bell:* If Winterflood, Mr Sotiriou and Mr Robins had FEI stock available, whether being offered to the market or as a long position accumulated by Winterflood that it wished to sell down, they were always able to (and did) sell such stock to SP Bell, regardless of market conditions. SP Bell’s purchases did not represent genuine demand for FEI shares. This consistent selling to SP Bell was likely to give a regular user the impression that there were a significant number of genuine buyers actively seeking to acquire FEI shares, in circumstances where this was not in fact the case.

22. *Regular user test: section 118(1)(c)*

(a) *Knowledge of unusual and concerning circumstances:* Winterflood, Mr Sotiriou and Mr Robins knew or ought to have known of a number of facts and matters that were highly unusual and cause for serious concern. In particular:

i. The circumstances of the initial sale of the original shareholders’ interest were out of the ordinary, not least because as owner of SP Bell and an intended director and shareholder of FEI Mr Eagle was acting on both sides of the sale. By selling and acquiring the shares through Winterflood Mr Eagle could ensure that the business would be reported to the market as ordinary trades, and this was not the usual way of transacting such business.

ii. Mr Eagle was in the very unusual position of having effective control and being senior executive of both FEI, an AIM quoted company, and SP Bell, a stockbroking firm which traded on AIM, which gave rise to an obvious conflict of interest between Mr Eagle’s personal interest in securing an increase in the FEI share price and his obligations to his clients.

iii. Mr Eagle preferred to discuss all matters, particularly those relating to trading by SP Bell in FEI, on untaped lines. This was suspicious and represented an obvious risk of impropriety.

iv. Mr Eagle through SP Bell consistently purchased FEI shares regardless of market conditions, wished to and did conduct via Winterflood a high and increasing number of rollover trades, including highly unusual delayed rollovers, involving a very large volume of shares, and wished to secure an increasing share price. This pattern of trading was extremely unusual.

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10 (b) *Execution of rollover and delayed rollover trades:* A regular user would reasonably expect a market maker to conclude that the rollovers and delayed rollovers were in breach of Exchange Rule 3050, that there was a substantial risk that they were not genuine and proper trades, and/or that they were likely to give a false and misleading impression and/or distort the market. The delayed rollovers in particular gave rise to risks beyond the immediate one of whether the second leg of the transaction would actually be executed. A regular user would expect the market maker to review the relationship with SP Bell and Mr Eagle, investigate the trades to ascertain whether they were genuine and proper, and decline to execute further trades if not so satisfied. Winterflood, Mr Sotiriou and Mr Robins failed on all counts.

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(c) *Consistent selling to SP Bell:* A regular user would reasonably expect a market maker to conclude that there was a substantial risk that the apparently continuous demand of SP Bell's clients for FEI shares did not represent genuine and proper trades, and that the trades were likely to give a false and misleading impression and/or distort the market. A regular user would expect the market maker to review the relationship with SP Bell and Mr Eagle, investigate the trades to ascertain whether they were genuine and proper, and decline to execute further trades if not so satisfied. Again, Winterflood, Mr Sotiriou and Mr Robins failed on all counts.

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(d) *Breach of Exchange Rules and Principles for Business:* A regular user would expect an authorised person and its employees to comply with the Exchange Rules and the Principles for Business, including (i) Exchange Rule 3300, which prohibits member firms from (among other matters) engaging in behaviour that creates or is likely to create a false and misleading impression or distort the market and engaging in conduct that contributes to a breach of the Exchange Rules by another member firm, and (ii) the Principles for Business, under which a firm must conduct its business with integrity and due skill, care and diligence and must observe proper standards of market conduct. Winterflood, Mr Sotiriou and Mr Robins failed to comply with these requirements.

## The Actuating Purpose Issue

23. We approach the Actuating Purpose on the basis that for the purposes of the preliminary issues the Applicants accept that their behaviour could, in principle, depending on the wording of the Code fall within the conditions prescribed by section 118, in that:
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- (a) It occurred in relation to a qualifying investment (FEI shares) traded on a prescribed market (AIM).
  - (b) It was (for the reasons set out in the Statement of Case and summarised above):
    - 10 i. likely to give a regular user of the market a false or misleading impression as to the demand for, or as to the price or value of, FEI shares; and/or
    - ii. such that a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.
  - 15 (c) It was (for the reasons set out in the Statement of Case and summarised above) likely to be regarded by a regular user of AIM who was aware of the behaviour as a failure on the Applicants' part to observe the standards of behaviour reasonably expected of market makers in their position.
  - 20 (d) It occurred in the United Kingdom.
24. However the Applicants contend that there is a further requirement which the Authority must prove before the Applicants can be found to have committed market abuse namely that they had an "actuating purpose" to mislead or distort the markets in the respects set out above. That requirement is not to be found in section 118 which is directed to behaviour and its effects and makes no reference to any requirement that there be an intention to mislead or distort the market. The conclusion that the section does not itself require there to be a subjective element is also consistent with the terms of section 123(2) of FSMA which provides, in the context of the power in section 123(1) to impose a penalty, as follows:
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- "(2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that –
    - (a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1),
    - or

(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.”

5 Paragraphs (a) and (b) of section 123(2) are inconsistent with it being a  
requirement of section 118 that there be an intention to mislead or distort the  
market. It was common ground between the Authority and the Applicants that  
the constituent elements of market abuse, set out in section 118, do not include  
any mental element requiring a specific intention to commit market abuse.  
10 Accordingly, if such a requirement exists it has to be imported from another  
source.

### **The Code**

15 25. The Applicants contend that the requirement that there be an intention to carry  
out market abuse is to be found in the Code.

20 26. The statutory requirement for the Authority to prepare and issue a code is  
contained in s.119 FSMA which provides as follows:

25 “(1) The Authority must prepare and issue a code containing such  
provisions as the Authority considers will give appropriate  
guidance to those determining whether or not behaviour  
amounts to market abuse

30 (2) The code may among other things specify –  
(a) descriptions of behaviour that, in the opinion of the  
Authority, amount to market abuse;  
(b) descriptions of behaviour that, in the opinion of the  
Authority, do not amount to market abuse;  
(c) factors that, in the opinion of the Authority, are to be  
taken into account in determining whether or not  
behaviour amounts to market abuse.”

35 27. The statutory effect of the Code is provided for in s.122 FSMA as follows:

40 “(1) If a person behaves in a way which is described (in the code in  
force under section 119 at the time of the behaviour) as  
behaviour that, in the Authority’s opinion, does not amount to  
market abuse that behaviour of his is to be taken, for the  
purposes of this Act, as not amounting to market abuse.

45 (2) Otherwise, the code in force under section 119 at the time when  
particular behaviour occurs may be relied on so far as it  
indicates whether or not that behaviour should be taken to  
amount to market abuse.”

28. There are thus “safe harbours” for a person accused of market abuse to the extent that the behaviour is described in the code as not (in the opinion of the Authority) amounting to market abuse (section 122(1)). Furthermore the Code, as it is in force at the time at which any behaviour occurs, may be relied on so far as it indicates whether or not that behaviour should be taken to amount to market abuse.
29. The Code describes its purpose. Its stated purposes and effect is set out at 1.1.8G-1.1.14G. In particular, 1.1.10G provides:
- “The Code ... describes behaviour that, in the opinion of the FSA, does not amount to market abuse. Section 122(1) of the Act (Effect of the code) provides that such behaviour is to be taken conclusively, for the purposes of the Act, as not amounting to market abuse. The relevant sections of the Code are identified by the letter “C” and are referred to as safe harbours.”
- 1.1.11G provides:
- “In accordance with section 122(2) of the Act, some of the provisions of the Code identified by the letter “E” may be relied upon so far as they describe behaviour which, in the opinion of the FSA, amounts to market abuse. In addition, in accordance with section 119(2)(c) of the Act, other provisions of the Code identified by the letter “E” describe factors that, in the opinion of the FSA, are to be taken into account in determining whether or not behaviour amounts to market abuse”.
- 1.1.12G provides
- “Explanatory guidance is provided in relation to some provisions of the Act and the Code. This guidance is indicated by the letter “G”. It does not form part of the Code but it is guidance made under the FSA’s general power to give guidance as set out in section 157 of the Act ....”
- 1.1.13G provides:
- “The Code is not an exhaustive list of all types of behaviour which may, or may not amount to market abuse, nor of all the factors to be taken into account in determining whether behaviour amounts to market abuse . . .”
30. The description of the status of the various provisions in the Code matches that contained in the Reader’s Guide to the FSA Handbook.
31. Winterflood did not contend that the Code was exhaustive; its contention was that where express provision is made in respect of certain categories of

behaviour then the Code may be relied upon in determining whether or not there has been market abuse. However Winterflood contended that it is open to the Authority under section 119 to make a provision which, whilst not constituting a safe harbour, identifies behaviour (s.119(2)(b)) or identifies factors relevant to categorising behaviour (s.119(2)(c)) in directory terms and which has the effect that, by virtue of s.122(2), an applicant is entitled to rely upon that identification to the extent that it indicates that behaviour does not amount to market abuse. Winterflood's case is that the Code identifies behaviour (by reference to the need for actuating purpose) which is not to be regarded as market abuse and Winterflood is entitled to rely upon that provision under section 122.

32. The provisions of the Code relied upon by Winterflood are those dealing with "artificial transactions" and "price positioning". Winterflood's case is that the relevant parts of the Code contain clear descriptions of behaviour that, in the opinion of the Authority, does and does not amount to market abuse within s.119(2)(a) and (b). These descriptions make it clear that only behaviour which has the relevant actuating purpose amounts to market abuse. That description may, by virtue of s.122(2), be relied upon by the Applicants because it indicates what behaviour should and should not be taken to amount to market abuse. Since it may be relied upon by the Applicants, the Authority cannot contend, and the Tribunal cannot find, market abuse inconsistent with that reliance.

33. The specific provision relied upon by Winterflood in relation to artificial transactions, is MAR 1.5.9E. This provides:

"A transaction which creates a false or misleading impression will not normally be considered to have a legitimate commercial rationale where the purpose behind the transaction was to induce others to trade in, or to position or move the price of, a qualifying investment or relevant product. This need not be the sole purpose for entering into the transaction or transactions, but must be an actuating purpose. Equally, transactions will not automatically be considered to have a legitimate commercial rationale simply because the purpose behind the transaction was to make a profit or avoid a loss (whether directly or indirectly)."

In relation to market distortion Winterflood relies on MAR 1.6.4E which provides:

"In order to fall within the distortion test:

(1) the behaviour must be such that a regular user would, or would be likely to, regard it as behaviour which would, or would be likely to, distort the market in the investment in question. Behaviour will amount to market abuse if the behaviour

engaged in interferes with the proper operation of market forces with the purpose of positioning prices at a distorted level. This need not be the sole purpose of entering into the transaction or transactions, but must be an actuating purpose.”

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34. “Actuating purpose” is defined in the Glossary to the Handbook as “ a purpose which motivates or incites a person to act”.

### **Artificial Transactions**

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35. In relation to MAR 1.5.9E Winterflood submit that the Code requires that Winterflood had an actuating purpose of positioning prices at a distorted level in order for it to have committed behaviour falling within section 118 (2) (b).

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36. In interpreting the Code we approach it on the basis that we should give expressions contained in it their ordinary meaning. We are also conscious of the fact that the consequences of a breach of section 118 may have serious consequences for a person found to be in breach. However it is plain that the Code does not purport to describe exhaustively the types of conduct which may or may not constitute market abuse (as noted in 1.1.13G and 1.2.13G). Moreover where the Code provides that certain conduct cannot amount to market abuse it categorises the conduct as C (i.e. a safe harbour).

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37. A mental element for some cases of market abuse is introduced under the “regular user” test contained in section 118(1)(c), by MAR 1.2. The general approach of the Code is set out at 1.2.5E:

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“The statutory definition of market abuse does not require the person engaging in the behaviour to have intended to abuse the market. Accordingly, it is not essential for such an intention or purpose to be present in order for behaviour to fall below the objective standards expected. However, in some circumstances, the determination of whether behaviour falls short of those standards will depend on the purpose of the person in question (for example, MAR 1.6.4E). In those circumstances, the regular user is likely to consider the purpose of the person in question in addition to the other relevant consideration listed at MAR 1.2.3E. This need not be the only purpose but should be an actuating purpose”

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38. MAR 1.2.5E therefore emphasises the general proposition that market abuse does not generally require a specific intent to abuse the market but that some types of behaviour will fall below the expected standards if an actuating purpose of the behaviour is as specified by the Code. The general proposition is further emphasised by other provisions such as 1.2.2E. and 1.2.3E. The latter provision lists certain circumstances to which the regular user might have regard. It does not refer to an actuating purpose. It is not surprising that an actuating purpose might affect the issue whether a person has committed an act of market abuse for the very reason set out at 1.2.5E.

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39. MAR 1.5.9E must be read in context. The introduction in MAR.1.5.1 to 1.5.3 is written in terms dealing with objective conduct. MAR 1.5.4 lists various elements of the test for false or misleading impressions and MAR 1.5.5E lists various general factors. There is no mention of actuating purpose.
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40. MAR 1.5.7 provides that MAR 1.5.8E, MAR 1.5.15E, MAR 1.5.18E and MAR 1.5.21E set out descriptions of behaviour described therein which will constitute market abuse in that the behaviour gives rise to a false or misleading impression. The descriptions in those paragraphs may be relied upon so far as they indicate whether or not particular behaviour should be taken to amount to market abuse. However they are not exhaustive of the types of behaviour which might constitute market abuse within section 118(2)(b). MAR 1.5.8E contains a description of one type of such transaction under the heading “artificial transactions” but provides an instance where a transaction, which might otherwise amount to market abuse within the example, will not amount to market abuse if the regular user would regard the principal rationale for the transaction in question as a legitimate commercial rationale (1.5.8(4)) and the way in which the transaction was executed as proper (1.5.8(5)E). MAR 1.5.9E is not referred to in the list of examples. That is because its function is to provide factors which might be taken into account in assessing whether a regular user would regard the principal rationale for the transaction described in MAR 1.5.8E as a legitimate commercial rationale. It is not a free standing description of behaviour amounting to market abuse but is dealing with a person who has the knowledge (or constructive knowledge) referred to in MAR 1.5.8(2)E but wishes to rely upon the legitimate commercial rationale as an exculpatory explanation. All MAR 1.5.9E does is to state that the exculpatory legitimate commercial rationale will not normally be available where the person has the prescribed purpose. MAR 1.5.10E serves a similar explanatory function in relation to the issue of whether a transaction is executed in a proper way.
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41. It is also noteworthy that actuating purpose is not expressly referred to in MAR 1.5.11E, which provides examples of factors which are to be taken into account when determining whether a person’s behaviour amounts to market abuse or in MAR 1.5.14E which provides examples of behaviour which might give rise to a false or misleading impression and in respect of which the principal rationale may not be a commercial rationale.
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42. Accordingly we reject Winterflood’s submission in reliance upon MAR 1.5.9E that the Code requires that Winterflood had an actuating purpose of positioning prices at a distorted level in order for it to have committed behaviour falling within section 118(2)(b). In our determination that submission fails to take into account the context and function of MAR 1.5.9E which is to provide a factor which will be taken into account when assessing whether a regular user would regard the principal rationale as a legitimate commercial rationale. MAR 1.5.9E does not purport to define what amounts market abuse, let alone provide an additional requirement which must be
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present before the requirements of section 118(2)(b) are satisfied. Furthermore had the draftsman of the Code sought to provide that the absence of an actuating purpose ensured that behaviour could not amount to market abuse he would have provided an express safe harbour provision to that effect.

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### **Market distortion**

43. Winterflood submit that MAR 1.6.4E under the heading “Element of the test” is framed in “unambiguous and unqualified terms” and that the Code requires that Winterflood had an actuating purpose of positioning prices at a distorted level. We do not consider that Winterflood’s interpretation of MAR 1.6.4E is correct. The first sentence of MAR 1.6.4E provides that the behaviour must be such that a regular user would, or would be likely to, regard it as behaviour which would, or would be likely to, distort the market in question. The second sentence merely describes an instance where behaviour with an actuating purpose will amount to market abuse. The second sentence does not purport to provide an exhaustive description of behaviour which will amount to market abuse or to set out an essential requirement which must be present before the requirements of section 118(2)(c) are satisfied.

44. By referring to an instance which will amount to market abuse the Code is not to be taken as providing that other circumstances will or will not amount to market abuse. The fallacy in Winterflood’s submission is that it assumes that the Authority in MAR 1.4.4E has “chosen to indicate, in clear terms, that certain behaviour (here: relevant behaviour without the relevant actuating purpose) is not market abuse, then that indication may be relied upon”. MAR 1.6.4E can not be read as providing that the absence of actuating purpose results in behaviour not amounting to market abuse. It simply states that certain behaviour with actuating purpose will amount to market abuse. It does not make any specific reference to behaviour occurring absent an actuating purpose and such conduct is not to be taken as excluded from market abuse by the express reference to actuating purpose in MAR 1.6.4E.

45. We also note that, consistently with the conclusion set out above, MAR 1.6.11E, which sets out a list of factors to be taken into account in determining whether behaviour amounts to market abuse, does not expressly refer to actuating purpose and that there is no safe harbour in MAR 1.6 where behaviour occurs absent an actuating purpose.

### **Determination of the Actuating Purpose Issue**

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46. Accordingly we determine the first of the preliminary issues in the following terms:

45 In order for Winterflood to have committed market abuse under section 118(2)(b) or 111(2)(c) of FSMA it was not necessary for Winterflood to have had an actuating purpose (as defined in the Code of Market Abuse) to mislead or distort the market.

47. As we have noted we heard no argument on the second of the preliminary issues (the Fresh Allegation Issue) which does not arise in the light of our determination on the Actuating Purpose Issue. Winterflood reserved its position in relation to that second issue and we propose to say no more about it.

**Conclusion**

48. The hearing of the preliminary issues was treated as a hearing of the reference. Accordingly the consolidated references are dismissed and the Authority should take the action referred to in the respective Decision Notices.

**SIR STEPHEN OLIVER QC**

**TERENCE MOWSCHENSON QC**

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