Finance
Case Law Update
Rosling King LLP

The Claim

The regulator issued proceedings against the investment firms Da Vinci Invest Ltd ("DVI") and Seychelles registered Mineworld, along with three individual traders who set up and controlled Mineworld (together, the "Defendants"), for committing market abuse.

The Defendants' alleged offences took place in 2010 and 2011 in the course of high volume derivative trading on the London Stock Exchange. The Defendants used tactics commonly known as 'spoofing' and 'layering' whereby traders attempt to give an artificial impression of market conditions in an attempt to manipulate prices and then trade from a position where they are able to make a profit.

The FCA sought a final injunction under s381 of the Financial Services and Markets Act (the "Act") to prevent a reoccurrence of the practice and asked the Court to impose a financial penalty for market abuse under s129 of the Act.

Traditionally the FCA has used its own regulatory powers under s123 of the Act to impose its own financial penalties on offenders. As this case was a departure from the usual position, one of the questions for the Court to consider was on what basis the FCA could request the Court to exercise its powers under s129 of the Act. The other key question for the Court to determine was whether, on the evidence available, a market abuse had occurred and, if so, whether an individual defendant's activities could be attributable to a corporate defendant.

The Decision

The Power of the Court to impose a Penalty

The High Court found that the FCA was fully within its rights to ask the Court to impose a financial penalty for market abuse under s129 of the Act and this was in no way subject to, or constrained by, the separate requirements for the exercise of the FCA's own power under s123. This meant that there was no requirement for the FCA to issue a warning notice and a decision notice when requesting that the Court invoke their powers under s129 of the Act.

There was said to be no material unfairness to a defendant faced with an application under s129 as opposed to the FCA imposing a regulatory penalty under s123. Further it was found that the Court's power to enforce a penalty under s129 did not only arise when an injunction had already been granted under s381.

Market Abuse

The Court agreed with the FCA that market abuse had occurred. In considering the evidence, it was deemed it was only necessary for the FCA to show that the same repeated patterns of trading were occurring, which ruled out any coincidence or other innocent strategy, to show that market abuse had occurred in accordance with s118(5) of the Act. It would be wholly impractical for the FCA to adduce subjective evidence from individuals engaged in the relevant market, dealing with trades at the relevant time. It could be inferred that the placing of these numerous trades on one side of the book gave, or was likely to give, a misleading

impression of supply and demand to other traders, and was therefore to be regarded as market abuse.

The traders raised the defence that they were not aware of the relevant behaviour expected from them. This was roundly rejected by the judge as being contrary to the purpose of the Act. The Court made it clear that, for a defence to be successful under s123(2) of the Act, it required some positive knowledge and consideration by the party in question as to whether the behaviour had been market abuse.

The Court also found that the behaviour of the traders was also attributable to the corporate entities. There was no requirement on the Court to find a mental element to market abuse, in accordance with s118(5) of the Act. The traders were authorised by the companies to place the trades through subaccounts in name of DVI and Mineworld, established through a contractual agreement and a direct market access service provider.

Penalty

The Court did not depart from the framework used by the FCA to calculate penalties because this could create inequality of treatment of defendants. However it was made clear that the Courts were not bound by this framework. In the circumstances, a penalty of £1.46m would be imposed on DVI and a penalty of £5m would be imposed on Mineworld. A penalty of £410,000 would be imposed on two of the traders and a penalty of £290,000 would be imposed on the remaining trader who was found to have committed market abuse during 2010, but not during 2011.

Commentary

This case provides a precedent for the FCA to choose an alternative method of dealing with suspected market abuse. It provides them with the option, instead of pursuing their own enforcement proceedings under s123 of the Act, to approach the Court to enforce a penalty. This places defendants in a position where they will not necessarily receive warning and decision notices when suspected of market abuse, and may lose the ability to negotiate a settlement with the FCA, which is generally available throughout regulatory proceedings. The Courts have shown their willingness to implement the rules surrounding market abuse transparently and impose heavy penalties in order to protect the integrity of the markets and the people who have invested in them.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.