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## The Spector Photo case: ECJ rules on the interpretation of the Market Abuse Directive

The European Court of Justice ("ECJ") recently handed down a judgment in the Spector Photo case<sup>1</sup> on the interpretation of Article 2(1) of the Market Abuse Directive<sup>2</sup> ("MAD"), which contains a pan-European prohibition on insider dealing. The ECJ held that, in relation to insider dealing market abuse, it is not necessary for national authorities to demonstrate that the person accused of insider dealing had 'used' inside information 'with full knowledge'. Instead, embedded in the definition of insider dealing there is a presumption that a person who is in possession of inside information and who deals in financial instruments to which the information relates 'uses' that information in contravention of the insider dealing prohibition. It is, however, open to such a person to rebut this presumption.

### Background

Spector Photo Group NV ("**Spector**") was a publicly traded Belgian company. It operated a stock option programme for its employees. In order to satisfy its obligations to transfer shares to employees, Spector purchased its own shares on the market both itself and through using the services of a Mr. Van Raemdonck. Following the purchase, Spector announced a planned takeover by its subsidiary of a rival company and also disclosed Spector's financial results, leading to an increase in its share price. These matters had clearly been in contemplation at the time of the dealing. The Belgian financial regulator investigated the purchases by Spector and Mr Raemdonck, found that they had committed insider dealing and imposed fines on them. The respondents brought an appeal before a higher court in

Belgium, which referred a number of questions to the ECJ.

One of the questions referred to the ECJ was whether it is sufficient, for a transaction to be classed as insider dealing, that an insider in possession of inside information trades on the market in financial instruments to which that information relates, or whether it is necessary, in addition, to establish that that person has 'used' the information 'with full knowledge'.

### The Court's reasoning

The ECJ held that Article 2(1) did not provide that prohibited transactions be carried out 'with full knowledge of the facts' but merely prohibited insiders from using inside information when entering into market transactions. The predecessor to Article 2(1) prohibited

<sup>1</sup> Spector Photo Group NV v Commissie voor het Bank, Financie-en Assurantiewezen, C-45/08.

<sup>2</sup> Directive 2003/6/EC.

anyone who possessed inside information from entering into transactions in relation to the securities concerned 'by taking advantage of that information with full knowledge of the facts'<sup>3</sup>. By contrast, MAD used a different formulation that omitted the words 'taking advantage' and 'full knowledge of facts'. The ECJ thought that this indicated that the European Parliament intended to replace 'to take advantage of' with 'to use' so as to remove certain elements of purpose or intention from the insider dealing definition.

The ECJ made it clear that the question of whether a primary insider in possession of inside information 'uses that information' within the meaning of Article 2(1) must be determined in the light of the purpose of the directive, which is to protect the integrity of the financial markets and to enhance investor confidence. The ECJ stated that "only usage which goes against that purpose constitutes prohibited insider dealing".

## Implications

The key implication of the Spector Photo decision is that the definition of insider dealing under EU law is an objective one. However, the emphasis on the objective terms used in the definition of the offence should not obscure the fact that both the 'possession' and the 'use' of information imply the existence of a mental state on the part of the person alleged to have committed insider dealing. The ECJ noted that Article 2(1) would not automatically catch any primary insider in possession of inside information who enters into a market transaction<sup>4</sup>. It is only usage going against the purpose of MAD that constitutes insider dealing.

The ECJ appears to create a legal presumption that anyone with inside information who enters a market transaction in relation to the relevant instruments will, if he or she fails to rebut the presumption, be found guilty of insider dealing. This could be considered to raise

difficulties in light of human rights law and also evidence in legal proceedings given that it is usually for the authorities to prove all elements of an offence.

The judgment could alternatively be interpreted as merely restating the obvious point that Article 2(1) does not require proof by the regulator that the primary insider acted with "full knowledge of the facts", without stripping the terms 'possession of information' or 'use of information' of their intrinsic mental elements. If this is the case then the judgment has little impact on current understandings and indeed, notably, on legislation in the U.K. that implements MAD which was drafted in light of those understandings.

Some commentators have suggested that the approach currently adopted by the U.K. and, in particular, the guidance issued by the Financial Services Authority ("FSA"), does not accord with the interpretation adopted by the ECJ in Spector Photo. Section 118(2) of the Financial Services and Markets Act 2000 ("FSMA") defines insider dealing as behaviour "where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question" (emphasis added). The FSA's Code of Market Conduct<sup>5</sup> regards the "on the basis of" test as a necessary element of the insider dealing offence.

However, assuming the judgment is not intended to effect any change to the law of evidence, there would be no necessary inconsistency between the ECJ's interpretation of insider dealing in Article 2(1) and the way this definition is applied in the U.K. The "on the basis of" test applied by the FSA enables the FSA to determine whether a person 'used' inside information when entering into a relevant transaction. This determination will involve some assessment of the person's mental state, although it is always open to the relevant tribunal to infer such a state from the facts and circumstances.

<sup>3</sup> Article 2(1) of Directive 89/592/EEC.

<sup>4</sup> Paragraph 45 of the judgment.

<sup>5</sup> Chapter 1 of the Market Conduct Sourcebook ("MAR") of the FSA Handbook.

Indeed, it is apparent from the Opinion of the Advocate-General in *Spector Photo*<sup>6</sup> that the court recognised that 'use' requires some mental element. Thus, the Advocate-General concluded that "in situations where it is clear *a priori* that inside information does not influence the action of a person, mere knowledge of inside information [when dealing] does not in itself imply use of that information" (emphasis added). An example cited was where a person sells shares even though he possesses inside information suggesting that the share price will rise, because he requires the proceeds of the sale immediately and cannot wait for the price to rise somewhat. Although this example is unrealistic (given that borrowing against the security of shares might be another means resolving the situation) in some cases it is possible that the inside information in no way influences

the decision to sell and therefore the sale does not constitute insider dealing. A better example in a corporate context would be where information walls prevent different parts of a company from 'using' information. The ECJ implicitly accepted this principle by stating that the regulator must assess whether the primary insider's conduct goes against the purpose of the MAD regime before it can conclude that the constituent elements of Article 2(1) are satisfied.

The FSA is examining the ECJ's judgment and will decide whether or not any amendments are required to the U.K.'s implementation of the MAD regime. It is to be hoped that a conservative interpretation of the ECJ's judgment will ultimately prevail and prior understandings will be seen to have been largely correct.

<sup>6</sup> Paragraphs 66 to 69 of the Advocate-General's Opinion.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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