MARKET ABUSE – Confidential information – Sales through Tokyo market of shares quoted on London Stock Exchange – Allegation that sales followed receipt by Applicant of confidential information – Tokyo market is not a "prescribed market" – Whether shares so sold were "traded on a market to which this section applies" i.e. the London Stock Exchange – Yes – Financial Services and Markets Act 2000 s.118(1)(a)

FINANCIAL SERVICES AND MARKETS TRIBUNAL

PHILIPPE JABRE **Applicant**

- and -

FINANCIAL SERVICES AUTHORITY **The Authority**
(Decision on Market Abuse)

Tribunal: STEPHEN OLIVER QC
IAN ABRAMS
SANDI O'NEILL

Sitting in public in London on 10 July 2006

Charles Flint QC, and Ben Jaffey, counsel, instructed by Kingsley Napley, solicitors, for the Applicant

Michael Brindle QC and Andrew George, counsel, instructed by the Financial Services Authority, for the Respondents

DECISION

1. This preliminary hearing was listed to determine the following issue:

> "Whether the investments to which the allegation of market abuse relates were at the relevant time "traded on a market to which this section applies" for the purposes of section 118(1)(a) of the Financial Services and Markets Act 2000."

Summary of background circumstances

2. The Applicant ("Mr Philippe Jabre") was a senior trader, employed by and a managing director of the hedge fund managers, GLG Partners LP ("GLG"). GLG was one of the largest hedge fund managers in Europe, managing approximately US $11.4 billion on behalf of its clients. Mr Jabre had over 20 years experience investing in international markets and was a specialist in the Japanese markets and convertible arbitrage strategies. Mr Jabre had been approved by the Authority pursuant to section 59 of the Financial Services and Markets Act 2000 (all statutory references in this Decision are to that Act) to carry on certain controlled functions on behalf of GLG.

3. On 11 February 2003, Mr Jabre was telephoned by a Mr Rustum, a salesman at Goldman Sachs and was "wall-crossed" or "restricted". Mr Jabre's reply says that "[Mr Jabre] understood that unless the restriction was lifted, or an issue was announced, he would not be able to make any trades based on any confidential information given to him during the call." Mr Rustum thereafter provided information to Mr Jabre about a proposed issue of securities by the Japanese bank, Sumitomo Mitsui Financial Group Inc ("SMFG"). There is a dispute about the significance of the information which Mr Jabre received. There is a further dispute about what Mr Jabre asked Mr Rustum at the end of the telephone conversation and what Mr Rustum said to Mr Jabre in a subsequent conversation between them. Mr Jabre says that (1) he informed Mr Rustum that he had "already been borrowing and shorting SMFG stock"; (2) he asked Mr Rustum "about the effect of their discussion on his existing trading pattern"; and (3) Mr Rustum subsequently telephoned him back, and informed him that "he was free to keep his existing trading pattern".

4. The case for the Authority in relation to the issues generally is that (1) Mr Jabre informed Mr Rustum that he had made requests to borrow shares in the four major Japanese banks; (2) Mr Jabre asked Mr Rustum what he should do with his existing requests to try to borrow shares in the four major Japanese banks and (3) Mr Rustum subsequently telephoned him back and said that Mr Jabre should not initiate any new requests to locate or borrow SMFG stock but that he did not have to, and indeed was not to, cancel the pre-existing orders which were already in place.

5. The e-mail advice which Mr Rustum received from his compliance department prior to his second conversation with Mr Jabre has been disclosed by Goldman Sachs. It states, among other things, "[Mr Jabre] cannot put out any new orders or trade [SMFG] at all". After his second conversation with Mr Jabre, Mr Rustum e-mailed

his compliance department and wrote, "I spoke to [Mr Jabre] just now and he understands."

6. On 12, 13 and 14 February 2003, Mr Jabre conducted a significant number of short sales in SMFG shares. For the purposes of this preliminary issue we take those sales to have been effected through the Tokyo market. As a result of the heavy fall in the SMFG share price following the announcement of the issue, Mr Jabre was able to make a substantial profit.

7. The essence of the Authority's case, so far as this preliminary issue is concerned, is that the short sales were based on the confidential information Mr Jabre had received from Mr Rustum and amounted to market abuse within section 118.

8. The Decision Notice followed an oral hearing before the Regulatory Decisions Committee of the FSA. FSA Enforcement and Mr Jabre were represented and made submissions. The Decision Notice starts as follows:

> "1.1 For the reasons set out below … the FSA has decided to impose a financial penalty of £750,000 on Mr Jabre because:
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> (a) Mr Jabre has committed market abuse contrary to section 118 of FSMA;
> (b) Mr Jabre has breached Principles 2 (Due Skill, Care and Diligence) and 3 (Market Conduct) of the FSA's Statements of Principle for Approved Persons.

The Statutory Framework

9. Prior to its amendment with effect from 1 July 2005, section 118 read as follows:

> "118. (1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) –
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> (a) which occurs in relation to qualifying investments traded on a market to which this section applies;
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> (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.
>
> (2) The conditions are that –
>
> (a) the behaviour is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as

relevant when deciding the terms on which transactions in investments of the kind in question should be effected;

(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;

(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.

(3) The Treasury may by order prescribe (whether by name or by description) –

(a) the markets to which this section applies; and

(b) the investments which are qualifying investments in relation to those markets.

(4) The order may prescribe different investments or descriptions of investment in relation to different markets or descriptions of market.

(5) Behaviour is to be disregarded for the purposes of subsection (1) unless it occurs –

(a) in the United Kingdom; or

(b) in relation to qualifying investments traded on a market to which this section applies which is situated in the United Kingdom or which is accessible electronically in the United Kingdom.

(6) For the purpose of this section, the behaviour which is to be regarded as occurring in relation to qualifying investments includes behaviour which –

(a) occurs in relation to anything which is the subject-matter, or whose price or value is expressed by reference to the price or value, of those qualifying investments; or

(b) occurs in relation to investments (whether qualifying or not) whose subject-matter is those qualifying investments.

(7) Information which can be obtained by research or analysis conducted by, or on behalf of, users of a market is to be regarded for the purposes of this section as being generally available to them.

(8) Behaviour does not amount to market abuse if it conforms with a rule which includes a provision to the effect that behaviour conforming with the rule does not amount to market abuse.

(9) Any reference in this Act to a person engaged in market abuse is a reference to a person engaged in market abuse whether alone or with one or more other persons.

(10) In this section –

"behaviour" includes action or inaction;

"investment" is to be read with section 22 and Schedule 2;

"regular use", in relation to a particular market, means a reasonable person who regularly deals on that market in investments of the kind in question.

10. The relevant market is prescribed in the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001. At the relevant time the London Stock Exchange was a prescribed market. The Tokyo Stock Exchange was and is not a prescribed market.

11. "Qualifying Investment" includes shares, defined in Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 Article 76 as "shares … of a … body corporate".

The common ground

12. It is common ground that:

(i) SMFG shares were at the relevant time qualifying investments, i.e. shares of a body corporate;

(ii) SMFG shares were quoted at the material time on the London Stock Exchange's SEAQ International Trading System, which is a market to which section 118 applies. SEAQ International (the Stock Exchange Automatic Quotation System for International equity market securities) is a quote driven trading service. Under the rules of the London Stock Exchange, where a security is to be traded on SEAQ International, at least two market makers must register with the Exchange and must display on the Exchange system firm two-way prices for the security in question. There is no dispute, for the purposes of the preliminary issue, that SMFG shares were traded, at the material time, on SEAQ International;

(iii) Mr Jabre's alleged behaviour (i.e. selling short on the basis of information not generally available to those using the market) occurred in relation to SMFG shares; and

(iv) the shares in relation to which Mr Jabre's alleged behaviour occurred are shares of the same kind as SMFG shares traded on the London Market.

The finding of the Regulatory Decisions Committee

13. For the record we include the following finding from the Decision Notice:

"3.48 In his written representations Mr Jabre disputed that his alleged conduct could, as a matter of law, constitute market abuse contrary to section 118 … . In

summary, it was submitted on his behalf that the trades in the SMFG shares occurred on the Tokyo market and therefore could not fall within the provisions of section 118. In its written representations, GLG adopted Mr Jabre's submissions that his trading did not occur on a prescribed market for the purposes of section 118 …

3.49 The FSA finds that, on a proper interpretation of the provisions of section 118(1)(a) …, the behaviour of Mr Jabre did occur "in relation" to "qualifying investments" (SMFG shares) traded on a "prescribed market". The "prescribed market" in question is the OINT segment of the London Stock Exchange's (LSE) SEAQ International System. SEAQ International has since been closed and SMFG's shares are now traded on the ITBU segment of the LSE's International Bulletin Board which is itself a "prescribed market"".

The case for Mr Jabre

14. The SMFG shares which were the subject of the short sales were not, it was contended for Mr Jabre, traded by him on the London market. They were traded on the Tokyo market. It would therefore breach the "territoriality" principle for a market abuse penalty to be imposed in exercise of a power under section 123.

15. The critical question, based on the correct understanding of section 118(1), is whether the behaviour of the person in question, being behaviour of one of the sorts categorized in subsection (2), occurs in relation to qualifying investments traded on a market to which section 118 applies; and for this purpose, it is the shares actually traded that count and not all the shares of the same kind. In the circumstances, it is contended, Mr Jabre's sales on the Tokyo market, which are alleged to have been sales based on information which was not generally available to those using the market, (i.e. behaviour within subsection (2)(a)) did not amount to "behaviour" that occurred "in relation to qualifying investments" that were also traded on the London market. That construction, it is argued, adopts a wording that resolves any ambiguity in favour of the "accused" person, i.e. Mr Jabre.

16. It was pointed out for Mr Jabre that the purpose of section 118 (prior to its amendment) was to regulate conduct in relation to the UK markets; to that end the Treasury prescribed only UK markets and not global markets.

17. Moreover, it was argued, conduct that distorts the Tokyo market and has no effect on the London market cannot, on the proper construction of section 118, constitute market abuse simply because the shares in question are listed on both markets.

18. Sections 118(1)(a) and 118(2)(a) distinguish between "qualifying investments" and "investments of the kind in question". "Qualifying investments" is a reference to a class of investments, but section 118(6) makes clear that the behaviour must occur in relation to "those qualifying investments". Accordingly, read as a whole, section 118 requires that the behaviour should occur in relation to particular investments within the class of "qualifying investments".

19. It was also argued that section 118(1)(a), prior to the 2005 amendment, says "traded" and not "admitted to trading" or "listed". The investments in relation to which the conduct occurred were actually traded, or being traded, on the Tokyo market. It is immaterial, it was argued, that "investments of the kind in question" were also listed on the London Stock Exchange.

20. The reference to a "market" is, it was argued, a critical element in the offence of market abuse. It is that market which sets the "regular user" test under section 118(1)(c). It is the "regular user of that market", not the regular user of another market on which investments of the kind in question are listed. In each of the subsections of section 118(2) the issue of abuse must be determined by reference to the effect on that market in relation to which the behaviour occurs, i.e. "the market" not "a market on which investments of the kind in question are traded". Section 118(10) in referring to a "particular market" reinforces the point that the conduct must occur in relation to an identified market.

21. Our attention was also drawn to the fact that section 118(1) has been amended to widen the scope of the market abuse regime. The amended section 118(1) came into force on 1 July 2005 and thus does not apply here. However, it is relevant to show the narrowness of section 118(1) as originally enacted. Behaviour which occurs in relation to qualifying investments "admitted to trading" on a prescribed market (see the new wording of section 118(1)) is now covered by the market abuse regime. Under the amended section 118(1) relevant investments need not actually be "traded on" a qualifying market; they need only be "admitted to trading". At the material time, SMFG shares were "admitted to trading" on the London market, but the shares in question were not, it was argued, "traded on" the London market.

The case for the Authority

22. There being no dispute that SMFG shares, being qualifying investments traded at the material time on SEAQ International (i.e. a market to which section 118 applies), the requirements of section 118(1)(a) are satisfied.

23. Mr Jabre's case that section 118(1), in referring to the shares actually admitted (as distinct from all the SMFG shares available to be traded on all markets), is wrong. The Authority's arguments in response to that are summarized in the course of our conclusions.

Conclusions

24. For "behaviour" to be classed as market abuse by section 118(1), it has to satisfy three free-standing tests. Each is independent of the others. Subsection (1)(a) refers to the asset to which the behaviour must relate. Subsections (1)(b) and (c) relate to the nature of the behaviour.

25. For the behaviour to come within subsection (1)(a) the behaviour must occur in relation to qualifying investments traded on a market to which section 118 applies.

Shares in SMFG were the subject-matter of the behaviour. These were traded on the SEAQ International system of the London Stock Exchange. Those features, on the face of it, bring the behaviour within subsection (1)(a), construed according to its ordinary and unstrained meaning.

26. We recognize that (for the purposes of this preliminary issue where we have proceeded on agreed facts) the actual shares to which the alleged abusive behaviour is said to have related were sold short on the Tokyo market. We do not however accept Mr Jabre's argument that the expression "traded on a market to which this section applies" in subsection (1)(a) refers to the actual shares that were the subject-matter of the abusive behaviour. That does not follow from the ordinary meaning of the words used in section 118, nor is it a necessary inference to be drawn from the context.

27. The words of subsection (1)(a), as we have already noted, refer to the asset, i.e. the qualifying investments. The behaviour that constitutes market abuse as described in subsection (2) does not require the identification of any particular shares as being the qualifying investments to which the behaviour relates. We agree with the observations for the Authority that in many market abuse cases, for example disseminating false rumours or disclosing inside information, it will not be possible to identify any particular share or group of shares which were the subject of the wrongful "behaviour". No wrongful dealing in shares is necessarily involved. And in relation to an insider dealing case, such as that currently before us, it may well be the case that the insider dealing has no effect on the relevant company's share price anywhere in the world.

28. Nor in our view does the prima facie construction that we have reached violate any "territoriality" principle. The abusive behaviour, irrespective of where it is taking place, has to relate to the UK market, hence the requirements in subsections (1)(a) and (5)(b) that the qualifying investments should be traded on a market to which the section applies, i.e. the London market. Focussing on insider dealing in the context of the territoriality principle we have already noted that it is not prohibited because it distorts share prices. The vice of insider dealing, and the reason why it is prohibited, is that it reduces confidence in the integrity and transparency of the market in the particular security which is being abused. Insider dealing in SMFG securities, wherever it occurs, destroys confidence in the global market in SMFG securities. The Authority's function is territorial; it is to protect the London market as a prescribed market and to preserve the integrity of its institutions. The Authority has an interest in preventing market abuse that impacts on the market and its institutions because the abuse relates to shares traded within the territory of its authority.

29. We also accept the observations of the Authority that, if it were right that, as Mr Jabre argues, the behaviour must relate to actual shares traded on the London market, then an individual who received inside information in London in relation to a FT-SE 100 company could, rather than carry out a trade in London, simply identify a market somewhere else in the world which was not prescribed, for example New York, and trade there on the basis of his insider information. In this connection it is inconceivable that it was Parliament's intention that the phrase "qualifying

investments" in section 118(1)(a) should be interpreted, as is contended by Mr Jabre, as "a particular sub-set of qualifying investments" so as to provide such an absurd result.

30. For all those reasons we are satisfied that the SMFG shares to which the allegation of market abuse relates were at the relevant time "traded on a market to which this section applies" for the purposes of section 118(1)(a). We determine the preliminary issue accordingly.

Liberty to apply

31. Both parties are at liberty to ask for a Directions hearing. The application should be made not earlier than 21 days after the release of this Decision and not later than 48 days from that date.

STEPHEN OLIVER QC
CHAIRMAN

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