GIURISPRUDENZA PENALE

Sanctioning regime for Market Abuse: the role of the European Court of Human Right

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During the two past decades, financial markets have become increasingly global and interconnected, giving rise to considerable benefits to national economies, investors and savers, by creating new trading platforms and technologies.
This unfortunately has changed the structure of markets, creating new risks and challenges for market participants and policymakers and has also led to new possibilities to manipulate these markets.
Financial markets are of central importance to our economic system. Indeed, they constitute the most vital economic institution of modern societies. For these reasons, the European Parliament has voted to formally endorse the political agreement on a Regulation on insider dealing and market manipulation to tackle market abuse more effectively.
The different bundles of regulations which address the different segments of financial markets have discrete objectives, drivers and components. But, overall, securities and markets regulation has primarily been directed to the support of market efficiency, transparency, integrity, in relation to consumer/investor protection. EU securities and markets regulation is based on the Treaty objective of constructing an intern single market (Art. 3(3) TEU), which is part of a wired project to create an area without internal frontiers in which the free movements of goods, persons, services and capital are ensured (Art.6 TFEU).
The first directive regarding the fight against the abuse of inside information dates back to 1989.
Directive 89/592/CEE provided a definition for new types of offences relating to insider trading and required the national legislators to apply sanctions - not necessarily criminal - that in any case were to be «effective, proportionate and dissuasive».
This directive gave birth, in Europe, to a sort of «euro-crime» of insider trading with a tendency towards the adoption of criminal sanctions.
In 2003, the communitarian legislator adopted a new directive on Market Abuse, which has become the point of reference in this field. In fact, the existing sanctioning regimes enacted by the Member States against all financial crimes are currently based on it.
In the last decade, the Directive 2003/6/CE was repealed by Regulation No. 596 of 16 April 2014 and Directive 2014/57/EU of 16 April 2014. This new legal

framework has introduced a radical change of direction in matters of sanctioning regimes and took note of the market and technological developments.
Clarifying what is meant by market manipulation and insider trading shall be the starting point for the subsequent reflections on the sanctioning regime.
Market manipulation involves actions intended to cause an artificial movement in the market price, so as to make a profit or avoid a loss. One common example involves a situation where false information is released into the market, such as a rumor that a takeover offer is about to be made for a company, in order to increase the price of the securities and let the manipulator profit from the price change. Another common example involves artificial trades designed to change the price of the security, such as 'wash sales', where a trader simultaneously buys and sells the same securities (that is, trades with himself) to give the appearance of a legitimate transfer of title or risk, or both, at a price outside the normal trading range for that investment, in order to move the price of those securities artificially.
Otherwise, in the US, 'market manipulation' refers only to actions aimed at artificially moving prices through trading activity, while in the EU 'market manipulation' includes both actions, known as 'trade-based manipulation' and 'information-based manipulation' which a US lawyer would refer to as securities fraud.
In the EU, the justification for regulating these two forms of activity is the same; to facilitate the 'smooth functioning of securities markets'. By contrast, in the US the two concepts retain their separate identity to a greater extent, as the justifications for regulation have tended to differ somewhat.
Insider trading can be broadly defined as the use of inside information (namely, 'price-sensitive' information that has not been made available to the public) about a company or its securities, in order to make a profit or avoid a loss through trading activity.
For example, a director may know that the company is about to announce that it has made substantial losses, and he sells his shares in the market in advance of the disclosure of that information and the inevitable drop in share price that will result from it. A common example is where a director knows, as a result of his position, that a takeover offer is about to be made for the company at a substantial premium to the current market price for the shares. Once this information is made public the share price is likely to rise, but before this occurs the director buys a block of the company's shares in the market in order to profit from that subsequent rise in value. Target firm stock prices do in fact almost invariably increase following the announcement of a takeover bid. We also often observe a price run-up in the days immediately preceding the public announcement of the bid, which most likely reflects profit-seeking activity by knowledgeable insiders.
As to the sanctions, the repealed Directive 2003/6/EC compelled the Member States only to provide for administrative sanctions: Art. 14: " *Without prejudice to the right of Member States to impose criminal sanctions, Member States shall ensure, in conformity with their national law, that the appropriate administrative measures can*

be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive".

The effect produced by the Directive 2003/6/CE and the widespread climate of alarm raised from the economic crisis and the financial scandals has generated a real wave of criminalization regarding market abuse- criminal sanctions may range from imprisonment to financial penalties and disgorgement of profits. The response of the national legislators to the Directive was very different from country to country as to the type and extent of the sanctions, even if the two offences were introduced in almost every country *ex novo* and simultaneously. The choice of enforcement regime (civil, administrative, criminal) is thus a mix of minor European obligations and major national policy choices. The result is that the triggering of enforcement jurisdiction and adjudicative jurisdiction is to a large extent dependent upon a fragmented patchwork of prescriptive jurisdiction in every single jurisdiction of every Member State. The Italian legislator enacted Law n. 62 of April 18th, 2005 and Law n. 262 of December 28th, 2005.

Different approaches by Member States undermine the uniformity of conditions of operation in the internal market and may provide an incentive for persons to carry out market abuse in Member States which do not provide for criminal sanctions for those offences.

The absence of common criminal sanction regimes across the Union creates opportunities for perpetrators of market abuse to take advantage of lighter regimes in some Member States.

The lack of effectiveness and dissuasiveness of the sanctioning regime was reduced by the Regulation No. 596 and the Directive 2014/57/EU.

The Art. 3 Directive 2014/57 states that *"Member States shall take the necessary measures to ensure that insider dealing (market manipulation), recommending or inducing another person to engage in insider dealing as referred to in paragraphs 2 to 8, constitute criminal offences at least in serious cases and when committed intentionally."*

It thus introduces a moral element (*mens rea*) into the definition of insider dealing and market manipulation which is, as far as primary insiders are concerned, arguably at odds with the case law of the Eu Court of Justice, which we will analyse in detail later, and the current practice of the Member States that already enforce market abuse rules through criminal law.

Hence, it is clear that, the communitarian legislator believes that the introduction by all Member States of criminal sanctions for at least serious market abuse offences is therefore essential to ensure the effective implementation of Union policy on fighting market abuse. Nevertheless, the vagueness of the provisions themselves displays a great weakness. The aim to restrict criminalisation to "at least serious cases" makes it hard to draw the line towards less serious conduct and the mere wording “intentional commitment” fails to render *mens rea* of the crimes more precisely, especially in the light of the Spector-decision.

As noted above the most primary and common justification given in favour of regulation of insider trading is that such activity will cause investors to ‘lose confidence’ in the market, believing it to be unfairly rigged against them. In addition, on ethical level it is contrary to good business values that a man holding a position of trust in a company should use confidential information for his personal benefit.

Like the two sides of a coin this practice of insider trading also has two contradicting views attached to it. There have been many strong arguments against the prohibition of insider trading from various economics and legal scholars. They say: “Necessity is the mother of invention. If this is true, the Commission’s Proposal for a Directive on Criminal Sanctions for Market Abuse could be considered an orphan.” In fact, paradoxically, a prohibition on insider trading makes the potential rewards higher for those still willing to do so, by reducing competition from other insiders. Consequently, the intensity of enforcement is very important for the efficacy of insider trading regulation.

Furthermore, there are some who suggest that if informational efficiency is the goal of securities regulation, we would do better to allow insider trading to take place without interference. It has been suggested that insider trading provides a good method of channeling information to the market, including information that companies would not disclose publicly, perhaps because it would be too expensive to do so, or because disclosing it publicly would destroy the value of the information. Without insider trading, it is suggested, this information will not be factored into the price, since in the semi-strong form of the efficient capital markets hypothesis only publicly available information is fully reflected in the price of the securities. Therefore, allowing insiders to trade on that information would increase informational efficiency, since the inside information would then be reflected in the price of the securities.

The theories and views for and against the regulation of insider trading presented above shows that this debate is ongoing. On one hand strong arguments are provided in favor of regulation of insider trading, while on other hand convincing arguments are provided against the regulation that prohibition of insider trading does not rests on a firm ground as it fails to provide an effective justification for treating insider trading as an evil. Hence there is no final conclusion to the debate. But insider trading continues to be prohibited in almost every securities market around the world.

In addition, insider trading is an extraordinarily difficult crime to prove. First, it can be hard to determine what the accused actually knew at the time the trades were made. Second, it can be challenging to establish that a particular individual was responsible for a trade, because knowledgeable traders can “hide behind” a variety of proxies and complete their trades over a number of international markets, many of which do not cooperate with the authorities. Furthermore, direct evidence of insider trading is rare and unless the defendant confesses or the prosecutor has access to testimony from an eyewitness whistleblower, cases are almost entirely

circumstantial, taking also into account that burgeoning swaps and options markets afford insiders more sophisticated tools for avoiding detection. Finally, the details of insider trading cases can be difficult to grasp by non-experts, thereby making it more difficult for prosecutors to convince juries that an actionable crime has been committed.
Since the administrative and criminal proceedings are separately ruled by the *ne bis in idem* principle at EU level, there is no common European standard in the event of a concurrent occurrence of an administrative and criminal sanction. This means, for example, that a European ‘citizen, would be punished twice with a punitive administrative fine and a criminal penalty for EU subsidy fraud in one EU Member State while he is protected against that type of double punishment in another EU Member State. Indeed, neither the mutual legal assistance and mutual recognition instruments, nor the main supranational sources on *ne bis in idem* totally cover the scope of punitive non-criminal sanctions. Nevertheless, both the ECJ and the ECtHR, jointly the changes introduced by the regulation, have taken giant steps in extending the links of relevant text wording.
The Art. 30, Regulation no. 596/2014 is emblematic. Indeed, it states that “*Member States may decide not to lay down rules for administrative sanctions (…) where the infringements (…) are already subject to criminal sanctions in their national law by 3 July 2016.*”
With regard to the *ne bis idem* principle, the Art.4, par. 1, Additional protocol n. 7, and the Art. 50- Charter of Fundamental Rights of the European Union establish that: “*No one shall be liable to be tried or punished again in criminal proceedings under the jurisdiction of the same State for an offence for which he has already been finally acquitted or convicted in accordance with the law and penal procedure of that State. 2. The provisions of the preceding paragraph shall not prevent the reopening of the case in accordance with the law and penal procedure of the State concerned, if there is evidence of new or newly discovered facts, or if there has been a fundamental defect in the previous proceedings, which could affect the outcome of the case.”*
The scope of the prohibition depends mainly on how the term «offence» is defined. In a second proceeding, the Judges will have to determine whether the “same offence” has already been subject to a previous judgment. The Court shall examine whether the previous judgment was based on the same penal provisions as the second judgment would be (*idem crimen*); or on the same conduct (*idem factum*).
Recent decisions of the ECtHR on *ne bis idem* principle, demonstrate the Court’s believes.
In the case of *Grande Stevens and Others v. Italy*, the Court held that persons responsible for market manipulation ought not to have been deprived of a public hearing or prosecuted twice for the same offence.
The case concerned an appeal against the administrative penalty imposed on the applicants by Consob, the Italian Companies and Stock Exchange Commission, and the concurrent criminal proceedings to which the applicants were subject after

having been accused of market manipulation in the context of a financial operation involving the car manufacturer FIAT.

According to the Court, the criminal proceedings against the applicants concerned offences involving facts which were identical to those for which the applicants had been finally considered liable by Consob. More importantly the Court ruled that the administrative penalties imposed by Consob may be considered, for the purposes of the European Convention on Human Rights, as criminal sanctions. Although the sanction was described as "administrative" in Italian law, the severity of the fines imposed on the applicants meant that they were criminal in nature, according to "Engel criteria".

Indeed, it is well-known that since 1971 (Engel case) the Court uses the so-called "Engel-criteria" to determine whether a prosecution is a "criminal charge" in the meaning of the Convention; The first criterion is the legal classification of the offence under national law, the second is the very nature of the offence and the third is the degree of severity of the penalty that the person concerned risks incurring. The second and third criteria are alternative and not necessarily cumulative.

In its 4th of March decision, the European Court of Human Rights held that a State cannot use national/internal classifications of sanctions to avoid application of this principle in its jurisdiction. In other words, States cannot arbitrarily classify sanctions as administrative rather than criminal to leave them out of the scope of action of the "*ne bis in idem*" principle[1].

A confirmation has been provided from another case law- Nykänen v. Finland- which in principles does not produce new results, but its internal effects will be of remarkable interest, also in consideration of the previous ruling. The ruling concerns a Finnish citizen firstly involved in a taxation proceeding and then charged with tax fraud before a criminal Court. In consequence of the first, he was applied a pecuniary fine of €1700 as surcharge. Afterwards, a criminal proceeding was carried out because of the same unlawful fact. Therefore, he lodged a complaint before the ECtHR, adducing a violation of article 4 of the 7th Protocol to the Convention. What the Court did first was evaluating the nature of that surcharge in the light of the Engel criteria. Recalling a previous decision, the judges anew affirm that a tenuous penalty does not automatically lead to the outcome of its non-criminal qualification. The Court attached attention to the purposes of the surcharge. In this particular case, the penalty sounded not as a damages compensation – that would justify its

[1] The *Grande Stevens* ruling has raised up an ample debate within the Italian state on how it may prevent a condemnation by Strasbourg. A first answer could be found in article 187*ter* of D.lgs. 58/98. The text of the provision establishing the administrative sanction for market manipulation begins with a pivotal phrase: 'Salve le sanzioni penali quando il fatto costituisce reato, (…). In addition, article 9 of L. n. 689/81 generally regulates that, where the same fact is simultaneously sanctioned by criminal and administrative law, the special rule has to be applied.

administrative nature, rather an out-and-out criminal sanction with preventive and repressive purposes.
For these reasons, the Strasbourg Court held that even €1700 of surcharge might have a criminal characterization, where it shares the functions of a criminal penalty. As a further step, the Court stated that, abstractly, parallel proceedings are not in breach of article 4. Nonetheless, in case one comes to a final judgment, the other has to be quitted; otherwise, the State will be accountable for that duplication. Thus, in the Nykänen case the criminal proceeding should have been closed, after the fiscal decision deliver. Basically, the Court ruled in the same way as in the Grande Stevens, where the administrative proceedings had become final before the criminal one.
However, a recent case law ruling demonstrates that a "Double track" system is not always impossible. In A and B v. Norway (judgment of 15 November 2016, n. 24130/11 and 29758/11) the Grand Chamber of the European Court of Human Rights restricted the scope of the aforementioned principle. Partly relaying on its previous case law, the Court upheld that Art. 4 of the Protocol no. 7 of the European Convention of Human Rights is not violated by dual proceedings conducted against an individual for the same conduct, if the proceedings are closely connected to each other in substance and in time. The European Court also listed a number of elements to test the intensity of the connection.
In this specific case, the applicants were prosecuted in the criminal and administrative proceedings for the same offence (tax fraud) and those were conducted in parallel and interconnected. The Judges determined the criminal sanction considering the amount already paid by defendants in the administrative proceedings.
In the view of the Court, "*States should be able legitimately to choose complementary legal responses to socially offensive conduct (such as non-compliance with road traffic regulations or non-payment/evasion of taxes) through different procedures forming a coherent whole so as to address different aspects of the social problem involved, provided that the accumulated legal responses do not represent an excessive burden for the individual concerned*".
In other words, it is insufficient that the purposes pursued and the means used to achieve them should in essence be complementary and linked in time, but it is necessary also that the possible consequences of organizing the legal treatment of the conduct concerned in such a manner should be proportionate and foreseeable for the persons affected.
The ECJ in *Spector Photo Group & Van Raemdonck v Commissie voor het Bank, Financie- en Assurantiewezen* clarified that where all of the constituent elements of article 2 of the Market Abuse Directive are satisfied, a rebuttable presumption that an insider "used" inside information contrary to the prohibition on insider dealing will arise. It is therefore not necessary for the national authority also to prove that the person had used the inside information "with full knowledge" or to prove any other subjective mental element.

Spector Photo Group NV 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 ruled that where it is established that a person has dealt while in possession of inside information, the use of that information may be presumed. This means that a regulator is not obliged to demonstrate that a decision to trade was caused or influenced by the possession of inside information; it need only establish that the possession of inside information by a primary insider-or by some other person who knew or ought to have known that it was inside information- and the fact of trading whilst in possession of that information.

Although evidence can be led to rebut that presumption, the burden is on the defendant to establish that he has not taken unfair advantage of the benefit gained from that information, and that the transactions were entered into legitimately and dutifully. In principle, this may well mean that some regulators may find it easier to prove market abuse in administrative enforcement cases. Firms should be giving some thought to how they record their decision-making processes in order to ensure that they are in a position to evidence that the trading of particular securities was wholly independent from the possession of inside information.

In conclusion, this analysis has shown the fundamental impact of case-law of the European Court of Human Rights on the field of market abuse, with specific focus on the sanctioning regime linked to that. First of all, it has explained what purposes may be found behind, respectively, administrative and criminal penalties as well as the criteria under which they have been developed under each domestic legislation. Secondly it has clarified the main purpose and significance of the prohibition of double-jeopardy, i.e. what exactly the *'ne bis in idem'* principle is for.

However, an interesting question remains open. Is it fair or unfair regulate the market manipulation? How to find a correct line between harmful trading and strategic trading? There are many aspects of how stability and growth is best promoted. Does market abuse represent an inevitable ingredient of financial insecurity?

At this stage, we can simply underline that the regulation should secure the market functions and enabling the enhancing of investor confidence and market efficiency, the prohibitions should be action-specific and not comprehensively sorted and the consumer perspective should not be the leading motive for legislation in this field.