The Use of Inside Information

Judgment of the European Court of Justice of 23 December 2009, Case C-45/08, Spector Photo Group, Chris Van Raemdonck v. Commissie voor het Bank-, Financie- en Assurantiewezen

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Article

ABSTRACT

The article discusses the ECJ's judgment in Spector Photo Group (C-45/08) on the interpretation of "use of inside information" under Directive 2003/6/EC. The Court held that possession of inside information combined with trading in the related financial instruments suffices to presume use, without proving intent, thus creating an objective definition of insider dealing. While this preventive approach strengthens market integrity, the Court also allowed defendants to rebut the presumption, invoking the principle of defense rights. The author critiques this reasoning as mixing factual presumptions with legal interpretation and questions whether the directive supports such a construction, warning of potential overreach when administrative or even criminal sanctions are applied.

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Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (hereinafter called Directive 2003/6/EC)[1] was enacted to combat these two most dangerous threats to capital markets.[2] The directive has been the subject of examination by the ECJ several times.[3] The point of my interest will be the judgment relating to the nature of the conduct constituting insider dealing. It was rendered on 23 December 2009 (C-45/08), to the effect of the reference made by the Belgian court in the course of proceedings between Spector Photo Group and one of its managers, on the one hand, and, on the other hand, the Belgian Commission for Banking, Finance and Insurance (Commissie voor het Bank-, Financie- en Assurantiewezen, hereinafter called "CBFA"). The questions referred to in the preliminary ruling concerned an interpretation of Arts. 2 and 14 of Directive 2003/6/EC.

I. The Case

Spector, a publicly quoted company under Belgian law, implemented a profit-sharing policy addressed to its staff members and offered them stock options. To realize the program, the company planned to use the shares in its possession and, if necessary, to buy the shares on the market. On 21 May 2003, Spector informed Euronext Brussels of its intention to implement the stock option program and to buy a certain number of its own shares. Between 28 May 2003 and 30 August 2003, Spector purchased 8000 shares in four transactions. On 11 and 13 August 2003, Mr. Van Raemdonck placed two purchase orders on behalf of Spector. In effect, Spector bought 19,773 shares at an average price of €9,97. According to the facts, the price of Spector's shares increased. The reasons were good results and the company's commercial policy, which Spector subsequently published information on. On 31 December 2003, the price of its shares had reached the level of €12,50.

The CBFA decided that the purchases made on the basis of the orders of 11 and 13 August 2003 constituted insider dealing and imposed fines of €80,000 on Spector and €20,000 on Mr. Van Raemdonck. They brought an action against this decision before the *hof van beroep te Brussel*. One of the questions submitted by the national court before the ECJ was how to interpret the expression "use of inside information" in Art. 2 (1) of Directive 2003/6/EC for the purposes of that provision. The Belgian court was also uncertain as to what type of evidence could be used to argue that inside information has been used within the meaning of Art. 2 of Directive 2003/6/EC. These issues were strictly connected to each other. In regard to the first issue mentioned above, the Belgian court formulated the following question: "Should Article 2(1) of [Directive 2003/6] be interpreted as meaning that the mere fact that a person as referred to in [the first paragraph of] Article 2(1) of that directive [who] possesses inside information and acquires or disposes of, or tries to acquire or dispose of, for his own account or for the account of a third party, financial instruments to which that inside information relates, signifies in itself that he makes use of [that] inside information?" The court also assumed that, if the answer to the aforementioned question is negative, then the criterion should be that a deliberate decision has to be taken by the person concerned to use inside information.

II. Use of Inside Information

Examining the case, the ECJ stated that the issue of the interpretation of the term "use of inside information" has to be examined before other questions are dealt with.[4] The essence of the problem is whether it is necessary to establish that the inside information was decisive in the process of making the decision to perform the market transaction. This interpretation requires proof of the intention of the perpetrator suspected of insider dealing. In other words, in order to substantiate that a concrete transaction is insider dealing, it would be obligatory to prove that the inside information had an influence on the decision to perform the market transaction and that a primary insider wanted to take advantage of that information.

Another way to interpret the term "use of inside information" is that it means that a person who possesses the inside information makes one of the aforementioned market decisions in regard to the financial instruments to which the concrete information relates. According to the second way of understanding the term "use of inside information," it is not necessary to prove that the inside information was the reason for the market decision. It is sufficient to present evidence of the possession of the inside information and the decision to acquire or dispose of the financial instrument to which the information relates (or the attempt to perform such a transaction).

According to the opinion of Advocate General Kokott, a person "makes use" of the inside information when he possess information that he knows, or ought to have known, constitutes inside information and acquires or disposes of financial instruments to which that inside information relates. It is important to emphasize that the Advocate General added that such a situation constitutes *"a rule."* If it is clear *a priori* that inside information does not influence the action of a person, the knowledge of inside information does not in itself imply use of that information.[5]

The ECJ decided that, according to the proper interpretation of Art. 2 (1) of Directive 2003/6/EC, the fact that the primary insider acquires or disposes of, or tries to acquire or dispose of, the financial instruments to which the inside information relates implies that that person has "used that information" within the meaning of this provision. The ECJ also added that the rights of the defense and the right to be able to rebut that presumption have to be respected. Any infringement of the prohibition on insider dealing must be analyzed in the light of the purpose of the directive, which is to protect the integrity of the financial markets and to enhance investor confidence.[6]

III. The ECJ's Interpretation

The interpretation of Art. 2 (1) of Directive 2003/6/EC by the ECJ raises doubts. To present them, it is necessary to investigate the grounds of the Court's position. The first argument presented in the judgment was that Art. 2 (1) of Directive 2003/6/EC does not include the subjective conditions in relation to the intention behind the material actions. According to the provision, it is not necessary to establish that the inside information was decisive in the decision to perform the market transaction at issue or that the primary insider was aware that the information in his possession was inside information. Moreover, the ECJ pointed out the difference between Art. 2 (1) of Directive 2003/6/EC and Art. 2 (1) of Directive 89/592/EEC[7] of 13 November 1989 coordinating regulations on insider dealing.[8] The insider's conduct was defined in Directive 89/592/EEC by the term "by taking advantage of that information with full knowledge of the facts," whose transposition into national law gave rise to various interpretation by the Member States.[9] In the new directive, the EU legislature wanted to avoid the problems that had arisen from the implementation of the earlier directive. Therefore, the history of the preparatory work shows that the EU Parliament wanted to remove any element of purpose or intention from the definition of insider trading.

According to the ECJ, the objectivity of the definition of the prohibited behavior (insider dealing) was intended.[10] Thanks to the objective construction of the prohibited behavior, it is easier to ensure the integrity of Community financial markets and to enhance investor confidence in these markets. Therefore, the EU legislature opted for a preventive mechanism. The Court of Justice agreed with the Advocate General that the condition of its effectiveness is a simple structure in which subjective grounds of defense are limited.[11] The solution is strictly connected to the specific nature of insider dealing.[12] The simple structure of the prohibited behavior, which is the effect of the proper interpretation of Art. 2 (1) of Directive 2003/6/EC, enables a presumption that mental elements exist when the perpetrator behaves in such a way. Taking into consideration the position of primary insiders, it is possible to exclude the possibility that the author of the market decision could have acted without being aware of his actions. In principle, the inside information is deemed

to have played a role in his decision-making. Therefore, the objective definition of insider dealing is justified. However, the ECJ added that such an interpretation could lead to the prohibition of certain market transactions, which do not necessarily infringe the interests protected by the directive.[13] It follows that the objective definition of insider dealing cannot exclude the rights of defense and the right to be able to rebut the presumption. The 18th recital in the preamble to Directive 2003/6/EC was recalled by the ECJ in order to underline the need to take the mental elements into consideration during examination if the concrete conduct constitutes insider dealing.

Referring to the position of the ECJ taken in the analyzed judgment, it should be emphasized that, on the one hand, the Court derived an objective definition of insider dealing from Art. 2 (1) of Directive 2003/6/EC, On the other hand, however, the Court is trying to avoid the consequences of such an interpretation of the provision. It remains open whether the interpretation was permissible in the light of the aforementioned provision.

The first reference should be made to the objective definition of insider dealing. According to the position of the ECJ, it is sufficient to prove insider dealing if a primary insider possesses inside information and acquires or disposes of the financial instruments to which the inside information relates. It seems logical, however, that if the legislature wanted to require only these two elements to be proven, Art. 2 (1) of Directive 2003/6/EC would be formulated in another way. There was no need to add the term "use of inside information." The expression seems to point out that the primary insider not only has to possess the information but also make use of it. Thanks to the mentioned term, it seems that the market decision has to be the effect of taking into consideration the inside information. During evidentiary proceedings, the presumption of facts may be used. From the fact that a primary insider possesses the information and he then makes the decision regarding the financial instrument to which the information relates, we may derive that the information was taken into consideration by him. There would still be the difference between the definition of insider dealing in Directive 2003/6/EEC and Directive 89/592/EEC.

Nevertheless, in the light of the analyzed judgment, such an interpretation is not correct. According to the ECJ, the only elements that have to be proven are: possession of inside information and performing the market decision. It raises questions as to what the consequences of the EU legislator decision are if understood in such a way. On the one hand, it enables a more efficient fight against insider dealing abuse and constitutes a preventive mechanism. On the other hand, it causes the risk of punishment for a conduct that contains the two aforementioned elements but does not infringe the integrity of the financial market. In other words, sometimes the conduct of a primary insider may fit the description of insider dealing in Art. 2 (1) of Directive 2003/6/EC, but it may not be harmful for the market. His decision may be independent from the facts that are derived from the information and even have an opposite character than can be expected.[14]

Presenting the argument about the role of the definition of insider dealing as a preventive mechanism, the ECJ emphasized that the EU legislature opted for administrative sanctions against insider dealing.[15] Using administrative measures against behavior that does not infringe market integrity but implies a high probability of this effect, is acceptable. However, this raises doubts as to when a criminal penalty may be imposed for a conduct formulated in such a way. According to Art. 14 (1) of Directive 2003/6/EC, deciding on the type of responsibility for infringement of prohibition of manipulation, the domestic legislator shall take into consideration whether the nature and severity of the sanction is proportionate and may have an effective and dissuasive effect. Evaluating the consequences of the decision of the EU legislator, it should be underlined that many of the Member States decided on criminalization of insider dealing. Moreover, the ECJ noted in the judgment that, even when the national legislator decided on administrative sanctions, such sanctions may, for the purpose of the application of the ECHR, be qualified as criminal sanctions.[16] The conclusion should

effect an even more cautious interpretation of Art. 2 (1) of Directive 2003/6/EC, because it may influence the interpretation of criminal law provisions in force in the Member States.

Nevertheless, when the ECJ noticed negative consequences of Art. 2 (1) of Directive 2003/6/EC interpreted in an objective way, it could only lead the Court to look for another way of interpretation or for formulation proposals regarding changes of the provision. The ECJ did something more, however, in the judgment analyzed. It recalled the concept of presumption, which enables the exclusion of responsibility for conduct that does not result in taking advantage of the benefit gained from the inside information.[17] In consequence, the ECJ presented the scope of conduct treated as insider dealing differently than it can be interpreted from the objective definition of insider dealing in Art. 2 (1) of Directive 2003/6/EC.

Although the motives that influenced the judgment of the ECJ are clear and acceptable, one cannot agree that the solution presented by the ECJ was supported by Art. 2 (1) of Directive 2003/6/EEC. The aforementioned provision does not constitute grounds for the possibility of exclusion responsibility of the primary insider who proves that the inside information did not influence his market decision. The lesson of the judgment leads to the conclusion that the ECJ found the grounds for its position in the concept of presumption.[18] The Court underlined that the presumption of law and of facts are permissible, to some extent, in criminal law. The limits derive from the principle of the presumption of innocence, laid down in Art. 6 (2) of the ECHR.[19] In principle, one can agree with the position as regards the permissibility of presumptions. The issue is whether the EU legislator contained the presumption of law in Art. 2 (1) of Directive 2003/6/EC. The general permissibility of the presumption of law does not mean that the presumption which can be rebutted is provided for in the concrete provision.[20]

The presumption of law exists in the EU competition law,[21] but the grounds are in the wording of the provisions, in their construction. Moreover, it has to be underlined that Art. 1(2)(a) of Directive 2003/6/EC contains a clause, according to which the responsibility is excluded if the orders or transactions, stipulated in the earlier part of the provision, are carried out for legitimate reasons. This clause reverses the burden of proof.[22] Thanks to the regulation, the possibility exists to take into consideration the subjective element of the behavior and change, to some extent, the objective nature of the responsibility.[23] However, there is no such a clause in Art. 2 (1) of Directive 2003/6/EC. Therefore, the analysis of the directive, especially the part dedicated to market manipulation, provides the argument that, if the EU legislature intended to include the presumption that can be rebutted, it would do it in the same way as in Art. 1(2)(a) of Directive 2003/6/EC.[24]

The argument regarding the presumption of facts is also not convincing. From the facts established in the case, other facts can be presumed, e.g., facts relating to the existence of some mental elements of the behavior, the intent of the perpetrator. The concept of presumption of facts is useful in the process of the establishment of the facts which have to be proven in order to declare that the offense has been committed. In Art. 2 (1) of Directive 2003/6/EC, however, the EU legislature has not provided for the mental element of the behavior that would be proven using the presumption of facts.

IV. Mixing Two Phases

Summarizing, the interpretation of the term “use of inside information” made by the ECJ raises doubts. The Court emphasized the objective nature of the definition of insider dealing but, to avoid the consequences of the interpretation of Art. 2 (1) of Directive 2003/6/EC, it recalled the concept of presumption, which is not supported in the wording of the provision. Whereas the argument regarding the presumption of facts means that the Court is mixing two different phases in the process of the application of law: the establishment of facts and the interpretation of law. The legislator may take into consideration the link between two factual elements during the construction of prohibited behavior. It is not, however, the effect of the concept

"presumption of facts." If the decision of the legislator confines the description of the behavior to some elements, then only these elements must be proven. It is the result of the policy of the legislator, which should not be changed by recalling the concept of presumption without a legal basis for it in the interpreted provision. The disadvantages of the objective definition of insider dealing may lead to a critique of the decision of the EU legislator or the attempts to define the term "use of inside information" in another way. If, according to the ECJ, the proposed objective interpretation of the term may lead to consequences that are inconsistent with the aim of Directive 2003/6/EC, perhaps the interpretation is incorrect. The 18th recital in the preamble to Directive 2003/6/EC, recalled in the analyzed judgment,[25] in which the EU legislator expressed its understanding of the term "use of inside information," gives rise to its interpretation in another way, which would still be different from the definition of insider dealing in Directive 89/592/EEC.

1. O.J. L 96, 12.4.2003, p. 16.↩
2. For more about the need and the aim of Directive 2003/6/EC, see: E. Avgouleas, The Mechanics and Regulation of Market Abuse. A Legal and Economic Analysis, Oxford: Oxford University Press, 2005, p. 250.↩
3. Judgments of the Court of Justice: Case C-445/09 IMC Securities BV v. Stichting Autoriteit Financiële Markten, 7.7.2011; Case C-19/11 Markus Geltl v. Daimler AG, 28.6.2012; Case C–248/11, criminal proceedings against Rareş Doralin Nilaş and others, 22.3.2012.↩
4. According to Art. 2(1) of Directive 2003/6/EC, *"Member States shall prohibit any person referred to in the second subparagraph who possesses inside information from using that information by acquiring or disposing of, or by trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates."*↩
5. Par. 69 of the Opinion of the Advocate General.↩
6. Par. 62.↩
7. Art. 2 (1) of Directive 89/592/EEC: *Each Member State shall prohibit any person who (…) possesses inside information from taking advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issuer or issuers to which that information relates.*↩
8. O.J. L 334, 18.11.1989, p. 30.↩
9. Par. 33-34.↩
10. Par. 35.↩
11. Par. 37.↩
12. Par. 36.↩
13. Par. 46.↩
14. Par. 46.↩
15. Par. 37.↩
16. Par. 42.↩
17. Par. 53.↩
18. Par. 43-44.↩
19. Part. 39, 43.↩
20. Some authors criticize the position of the ECJ because the Court replaced the presumption of innocence by the presumption of guilt, which does not comply with the objective of strengthening freedom, security and justice in the European Union. See: I. Seredynska, Insider Dealing and Criminal Law. Dangerous Liaisons, Berlin-Heidelberg: Springer, 2012, p. 26.↩
21. M. Böse, Case C-45/08, Spector Photo Group NV, Chris Van Raemdonck v. Commissie voor het Bank-, Financie- en Assurenatiewezen (CBFA), Judgment of the European Court of Justice (Third Chamber) of 23 December 2009, Common Market Law Review 2011, vol. 48, p. 196.↩
22. P.K. Staikouras, Four Years of MADness? – The New Market Abuse Prohibition Revisited: Integrated Implementation Through the Lens of a Critical, Comparative Analysis, European Business Law Review, Vol. 17, No. 4, 2008, p. 803.↩
23. A. Blachnio-Parzych, The Concept of Defining and Combating Market Manipulation in Existing and Proposed EU legislation, in: Regulating Corporate Criminal Liability, edited by D. Brodowski/M. Espinoza de los Monteros de la Parra/K. Tiedemann/J. Vogel, Springer, 2013, forthcoming.↩
24. M. Böse, op.cit., p. 198.↩
25. Par. 57.↩

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