

WINTERFLOOD APPEAL AGAINST FSA CENSURE

In an appeal heard on 9 March 2010 the Court of Appeal was asked to determine whether, as the FSA asserts, a legal entity can be guilty of market abuse absent any element of intention or knowledge (despite the reference to an “*actuating purpose*” in the Code of Market Conduct). If the Court of Appeal decides in favour of the FSA, it appears that the due diligence and trade monitoring required of traders will increase substantially.

In 2008 the FSA imposed one of the largest fines ever handed to a City institution. Winterflood Securities, a market-making subsidiary of UK merchant bank Close Brothers, and two of its traders were found to have been caught up in a broader scheme of market abuse. Winterflood was fined £4 million, while the two employees, Stephen Sotiriou and Jason Robins, were fined £200,000 and £50,000 respectively.

The fines were levied following the FSA’s investigation into dealings in shares of Fundamental-e Investments, a computer components company listed on AIM in 2004. The investigation established that stockbroking firm SP Bell and its controller, Simon Eagle, had initiated an illegal share ramping mechanism designed to inflate the value of Fundamental-e. A significant number of share trades were made through Winterflood, leading the FSA to conclude that it had “*played a pivotal role*” in the illegal venture owing to its failure to identify and act upon what the FSA called a “*series of unusual features*” inherent in the Fundamental-e third-party trades.

In 2008 the Financial Services and Markets Tribunal upheld the FSA’s argument, concluding that “*it was not necessary for Winterflood to have had an actuating purpose ... to mislead or distort the market.*”

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Winterflood argued before the Court of Appeal that, in order to prove market abuse under the regulator's Code of Market Conduct, the FSA must demonstrate that there was an intention on the part of a firm or individual to mislead or distort the market. The FSA's response was that neither an "*actuating purpose*" nor "*any form of mental element*" need be proved. It was irrelevant that Winterflood or its traders had not knowingly committed or abetted market abuse. It was enough that they had failed to question the legitimacy of third-party trades which, according to the FSA, should have alerted them to "*clear and substantial risks of market manipulation.*"

The Court of Appeal has reserved its judgment.

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