

The European Insider Trading Regulation after the ECJ's *Spector Photo Group*-Decision

Forthcoming European Company and Financial Law Review (ECFR) 2/2010

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Securities laws around the world agree that purchasing or selling financial instruments in possession of non-public, price-relevant information does not by itself constitute insider dealing. However, requiring more than the knowing possession of such information while trading – e.g. requiring some kind of fraudulent intent – might impede the effectiveness of any insider trading prohibition. Therefore, securities laws worldwide have to answer the question what exactly constitutes the mens rea requirement of insider trading. In a recent preliminary ruling¹, the European Court of Justice (“ECJ”, the “Court”) answered this question for the EU insider trading prohibition in Art. 2(1) of Directive 2003/6/EC² (“Market Abuse Directive”, “MAD”). After discussing the factual background and reasoning of the decision [I]³, this article provides an assessment from a comparative and methodological perspective, arguing that the Court should have exercised more judicial self-restraint [II)1) and II)2)]. It concludes with a summary of the most important dogmatic questions raised by Spector [II)3)].

I) **The ECJ’s Spector Photo Group-Decision**

1) **The Facts**

Spector Photo Group NV (“Spector”) is a publicly listed company incorporated in Belgium. It offered a stock option programme to its staff which it planned to back by acquiring its own shares. In connection with the plan, Chris van Raemdonck placed two orders in 2003 for Spector to acquire 19,773 of its own shares at an average price of € 9,97 (the exercise price of the options at issue being € 10,45). Spector’s share price rose and on 31 December 2003, it reached € 10.45. On 29 November 2006, the Belgian *Commissie voor het Bank-, Financie- en Assurantiewezen* (CBFA) imposed fines of € 80,000 on Spector and € 20,000 on Mr. van Raemdonck for violation of the Belgian insider trading prohibition. Spector and Mr. van Raemdonck contested this decision before the *hof van beroep te Brussel*. They based their defense on the principle of retroactivity *in mitius*. They claimed that there had been an intervening change in the Belgian insider trading regulation after Mr. van Raemdonck had purchased the options.

Article 25(1) of the Law of 2 August 2002 on supervision of the financial sector and financial services (*Moniteur belge* of 4 September 2002, p. 39121), stated:

¹ ECJ, Case C-45/08 *Spector Photo Group NV*.

² Directive 2003/6/EC of the European Union and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ L 96/16.

³ The decision will be discussed only to the extent relevant for this article.

„Any person who possesses inside information is prohibited from *using* that information by acquiring or disposing of, or trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, the financial instruments to which that information relates or connected financial instruments”.⁴

This rule was amended by the Framework Law of 22 December 2003 (*Moniteur belge* of 31 December 2003, p. 62160. The new rule states:

„Any person who possesses information which he knows, or ought to have known, constitutes inside information is prohibited from acquiring or disposing of, or trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, the financial instruments to which that information relates or connected financial instruments.”

Spector and Mr. van Raemdonck claimed that the new Article 25(1) did not comply with the definition of insider trading under Art. 2 of the Market Abuse Directive and therefore was inapplicable and left a vacuum comparable to a more lenient criminal law which prevented the CBFA from applying the initial Art. 25(1) of the Law of 2 August 2002.

The referring court was uncertain whether the new Article 25(1) is consistent with Art. 2 MAD and posed six questions to the ECJ for a preliminary ruling, among them and most importantly the following:

“2. 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?”

⁴ Italics added.

2) The Court's Decision

a) **The Spector Rule**

The ECJ's answer to Question 2 is, as a general principle, affirmative. Trading while in possession of material inside information normally constitutes use of such information.

In Question 2, the referring court essentially asked the ECJ whether insider trading as defined by Art. 2 MAD has any state of mind element beyond the possession of inside information, be it that the information was a *condicio sine qua non* for the insider's investment decision or that the insider had some fraudulent intent. The Court answers this question based on the wording of Art. 2(1) MAD, its genealogy and its purpose.

Starting with the wording, the Court finds that Art. 2(1) MAD does not expressly include a state of mind element.⁵ The genealogy underlines this finding, according to the Court. Art. 2(1) MAD replaced Art. 2 of the Insider Directive 89/592/EEC⁶ that sought to prohibit "any person who (...) possesses inside information from *taking advantage of that information with full knowledge of the facts* by acquiring or disposing of (...) transferable securities of the issuer or issuers to which that information relates".⁷ The Court notes that the transposition of that provision into national law gave rise to variances in the interpretation of the provision "with full knowledge of the facts" and thus impeded the goal of harmonising insider trading law within the EU.⁸ According to the Court, Art. 2 MAD aimed at filling this gap by removing any element of purpose or intention from the definition of insider trading – a conclusion which is supported by the wording of the Commission's proposal for the Market Abuse Directive and some of the preparatory work of the European Parliament when deciding upon the Market Abuse Directive.⁹

Finally, the Court explains that not requiring any further state of mind element follows from the purpose of the Market Abuse Directive. The ECJ defines this purpose as ensuring the integrity of Community financial markets and enhancing investor confidence in those markets (as demonstrated by MAD Recitals 2 and 12).¹⁰ According to the Court, the effectiveness of the insider trading prohibition would be weakened if made subject to the existence of a mental element: "The effective implementation of the prohibition on market transactions is thus

⁵ para. 32, 45.

⁶ Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing, OJ L 334/30.

⁷ Italics added.

⁸ para. 33.

⁹ para. 34.

¹⁰ para. 37.

based on a simple structure in which subjective grounds of defence are limited, not only to enable sanctions to be imposed but also to prevent effectively infringements of that prohibition”.¹¹ Thus, the Court concludes:

“On a proper interpretation of Article 2(1) of Directive 2003/6, the fact that a person as referred to in the second subparagraph of that provision, in possession of inside information, acquires or disposes of, or tries to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, the financial instruments to which that information relates implies that that person has ‘used that information’ within the meaning of that provision”.¹²

b) The *Spector* Exception

With reference to the principle of the presumption of innocence laid down, *inter alia*, in Art. 6(2) of the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR), the Court realizes that the *Spector* presumption must be open to rebuttal and that the rights of the defence must be guaranteed.¹³ Up to this point the Court’s decision is, as regards its results and reasoning, almost identical to the Advocate General’s (“AG”) opinion.¹⁴ However, the AG simply wanted to make an exception „in situations where it is clear a priori that inside information does not influence the action of a person, mere knowledge of inside information does not in itself imply use of that information”¹⁵. The Court goes significantly further:

“The question whether that person has infringed the prohibition on insider dealing must be analysed in the light of the purpose of that directive, which is to protect the integrity of the financial markets and to enhance investor confidence, which is based, in particular, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information”¹⁶. Only usage “which goes against that purpose constitutes prohibited insider dealing”¹⁷.

Thus, the Court sets out a two-step-framework for determining whether there is insider dealing under Art. 2(1) MAD: (1) The fact that a primary insider who holds inside

¹¹ para. 37.

¹² para. 62.

¹³ paras. 62, 38-44.

¹⁴ AG Kokott Opinion, C 45-08 *Spector Photo Group NV*.

¹⁵ Ibid para. 108.

¹⁶ para. 55.

¹⁷ para. 61.

information buys or sells (or tries to buy or to sell) financial instruments to which that information relates implies that that person used that information.¹⁸ (2) In order not to extend the scope Art. 2(1) of the Market Abuse Directive beyond what is appropriate and necessary, “certain situations may require a thorough examination of the factual circumstances enabling it to be ensured that the use of the inside information is actually unfair so as to be prohibited by the directive in the name of the integrity of financial markets and investor confidence”.¹⁹ Only usage which goes against that purpose constitutes prohibited insider dealing.²⁰

As clear as this roadmap is, the Court refuses to define the situations in which there is no unfair informational advantage and thus no insider trading. Instead, the Court refers to the express exceptions to the insider trading prohibition included in the Market Abuse Directive and its Level-2 implementations (see, for example, Art. 2(3) MAD) and the preamble to the Market Abuse Directive which provides several examples of such exceptions.²¹

II) Spector from Three Perspectives

The ECJ’s ruling in *Spector* is a significant decision. To assess its full significance, it is helpful to analyse *Spector* from three different angles: a comparative, a methodological and a dogmatic perspective.

1) The Comparative Perspective

To put *Spector* in a comparative perspective, it is useful to distinguish between the rule²² and its exception²³ addressed by the Court.

a) The *Spector* Rule

Most member states’ regulators interpreted the term “to use” in Art. 2(1) MAD as meaning that the inside information must somehow influence the insider’s trading. In the United Kingdom, s. 118(2) of the Financial Services and Markets Act (FSMA) requires that insider dealing be “on the basis” of inside information. This section has been interpreted by the Financial Services Authority (FSA) as requiring that the information have a material influence on the decision to engage in the dealing, although it does not have to be the only reason for

¹⁸ para. 54.

¹⁹ para. 55.

²⁰ para. 61.

²¹ para. 56-60

²² *Supra* I)2)a).

²³ *Supra* I)2)b).

the transaction.²⁴ Similarly, § 14(1) of the German Securities Trading Act (*Wertpapierhandelsgesetz*) provides that the insider must “use” (“*unter Verwendung*”) the inside information by trading in financial instruments, which has been interpreted by the *Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)* as demanding that the inside information influence (“*mit einfließen lassen*”) the decision without having to be its only cause.²⁵

In the United States, the mental element of insider trading law remains unsettled. In the seminal *O’Hagan* decision, the US Supreme Court stated that insider trading must be “on the basis of inside information” without specifying what exactly this means.²⁶ Lower courts have split on whether insider trading requires “knowing possession”²⁷ or that the insider “actually used material nonpublic information in consummating his transaction”²⁸. In 2000, the SEC adopted the new Securities Exchange Act Rule 10b5-1. It provides that a person trades “on the basis” of inside information if the trader is “aware” of the information when making the purchase or sale, thus denying any further state of mind element apart from the knowing possession of the inside information.

Perhaps the most remarkable development regarding a *mens rea* element of insider trading can be found in New Zealand. Prior to the 2006 amendments (which came into effect in February 2008), the New Zealand Securities Markets Act provided for a system of strict insider liability. There was no requirement that the insider used or took advantage of the information.²⁹ The person liable was not even able to avoid liability by proving that he or she had reasonable grounds to conclude that the information held was not inside information.³⁰ This system was reformed in 2006. The amended Securities Markets Act now defines an insider as “a person who (a) has material information relating to a public issuer that is not generally available to the market; and (b) knows or ought reasonably to know that the information is material information; and (c) knows or ought reasonably to know that the information is not generally available to the market”. This rule was closely modelled on the equivalent Australian provision which requires that the insider possesses inside information

²⁴ MAR (FSA Code of Market Conduct) 1.4.4; FSA Markets Tribunal, *Arif Mohamed and FSA* (29 March 2005), <http://www.tribunals.gov.uk/Finance/Documents/decisions/FinancialServicesMarketsTribunal/012.pdf>, para 68.

²⁵ BaFin, *Emittentenleitfaden* 2009, III. 2.2.1.2.

²⁶ *United States v. O’Hagan*, 521 U.S. 642, 656 (1997).

²⁷ *United States v. Teicher*, 987 F.2d 112, 120 (2d Cir. 1993).

²⁸ *United States v. Smith*, 155 F.3d 1051, 1069 (9th Cir. 1998).

²⁹ *Southern Petroleum No Liability v Haylock* [2003] 2 NZLR 175, para62; *Securities Commission v Midavia Rail Investments Bvba* [2007] 2 NZLR 454, para. 21 (CA); S. Griffiths in J. Farrar (ed.), *Company and Securities Law in New Zealand*, 2008, p. 1093.

³⁰ *Colonial Mutual Life Assurance Soc Ltd v Wilson Neill Ltd* [1994] 2 NZLR 152, 162 (noting that the total absence of fault would be important in determining the severity of the penalty).

and knows or ought reasonably to know that the information is price-relevant and not generally available [s. 1043A(1) Corporations Act 2001].

In summary, this short comparative excursion shows that the *Spector* levels the European insider trading regulation with the international standard (US, Australia, New Zealand). National insider trading laws of EU member states might have to be interpreted differently by the courts and competent authorities or – if such interpretation is not possible – changed by the legislator [Art. 249(3) EC]. While in most countries it was the predominant view that the insider trading prohibition required that the inside information influence the insider's investment decision, after *Spector* the usage of the inside information will be presumed, subject to the right of defence and rebuttal, whenever a primary insider as defined by Art. 2(2) MAD trades or tries to trade financial instruments while in possession of inside information.

b) The *Spector* Exception

While the rule created by the *Spector* Court conforms to most highly developed insider trading laws outside of the European Union, the same is not true for the *Spector* exception. In the United States, the SEC defines in Securities Exchange Act Rule 10b5-1 a clear-cut set of specific rules as to when an exception applies to the general rule that an insider trades on the basis of inside information when being aware of it while making the purchase or sale. A person's purchase or sale is not “on the basis of” material nonpublic information if the person making the purchase or sale demonstrates that before becoming aware of the information, he or she had (1) entered into a binding contract to purchase or sell the security, (2) instructed another person to purchase or sell the security for the instructing person's account, or (3) adopted a written plan for trading securities. Similarly, in Australia and New Zealand, there are several exceptions to the insider dealing prohibition. These exceptions are formulated as rules, and some specifically address the mental elements of the trade.³¹ The *Spector* decision, in contrast, relies on a standard (not a rule) which leaves much room for interpretation, as discussed below.³²

³¹ For Australia, see, for example, s. 1043D Corporations Act 2001 (acquisitions pursuant to a legal requirement); for New Zealand, see Securities Markets Act 1988 s. 10 (no knowledge of trading), 10C (fixed trading plan).

³² *Supra* II)1)a).

2) The Methodological Perspective

a) Equal Access as a Principle of the Market Abuse Directive

The brief comparative analysis points the way to a methodological critique of the *Spector* decision. In this regard, it is worth paying close attention to the language the Court uses when stating the *Spector* exception: According to the Court, insider dealing consists of an unfair advantage being obtained from inside information, which undermines the integrity of financial markets and investor confidence. This is “the essential characteristic of insider dealing”³³ and the “light” in which one has to decide whether a person has infringed the prohibition of insider dealing³⁴. Thus, “only usage which goes against that purpose (assuring that investors will be placed on equal footing and protected from the misuse of inside information) constitutes prohibited insider dealing”³⁵. The aforementioned statements show that the Court considers equal access among investors (market egalitarianism) as a *principle* of the Market Abuse Directive, thus putting *Spector* in line with its former decisions *Georgakis*³⁶ and *Grøngaard*³⁷, both of which were decided under the old Insider Trading Directive and which the Court expressly builds on in *Spector*^{38, 39}. Even though *Spector* seems to be in line with traditional EU securities law adjudication, the decision is remarkable in two aspects.

First, the *Spector* ruling differs considerably from the recent *Audiolux*-judgment in which the ECJ refused to recognize a general principle of equal treatment of minority shareholders under EU company law.⁴⁰ This difference in willingness to accept general principles under secondary Community law might be due to a different perception of the Court for the need of judicial activism. The reason might also be that EU company law is rather fragmental with respect to the substantive issues, whereas European securities regulation is much more inclusive (if not exhaustive) and detailed.

Second, as stated above, the Court’s decision differs considerably from the Advocate General’s opinion with respect to the *Spector* exception. The difference is important regarding

³³ para. 52.

³⁴ para. 62.

³⁵ para. 61.

³⁶ ECJ, Case C-391/04 *Georgakis* [2007] ECR I-3741.

³⁷ ECJ, Case C-384/02 *Grøngaard & Bang* [2005] ECR I-9939.

³⁸ paras. 47, 48.

³⁹ Essentially the same approach had been suggested before the Court’s decision by J. Lau Hansen, What constitutes insider dealing? The Advocate General’s opinion in Case C-45/08, *Spector Photo Group*, <http://ssrn.com/abstract=1499093>, sub. 4.3.

⁴⁰ ECJ, Case C-101/08 *Audiolux*, para. 52.

the kind of norm to be employed to determine whether an exception applies. While the Advocate General was thinking about a *rule* to distinguish insider trading from accepted market behaviour, the ECJ bases this distinction on a *standard* (“unfair use”), *i.e.*, the principle of equal access, the “essential characteristic of insider trading”. Whereas the Advocate General’s rule could have been adjudicated mainly by making *factual inquiries* into the *state of mind* of the supposed inside trader, the ECJ’s standard must be applied by developing *legal arguments* which have to take account not only of the subjective facts of the case, but also, among others of theoretical assumptions about how capital markets work. While the exception developed by the Advocate General *specifically* dealt with the mental elements of an individual possibly engaging in insider trading, the Court has created a standard which seeks to distinguish any case of “fair” use of inside information *generally* and is therefore much more inclusive. In other words, while the rule proposed by the Advocate General presumes judicial self-restraint, the ECJ exercised a good deal of judicial activism. And while the Advocate General’s rule was conform with approaches in other legal systems to define the subjective elements of insider trading (and their exceptions), the *Spector* Court chose a unique approach of trying to deduce all exceptions to the insider trading prohibition of Art. 2(1) MAD from the principle of equal access.

b) Trying to Explain the Court’s Activism

As explained, the *Spector* Court’s invocation of a general principle of equal access went beyond the reasoning put forward by the Advocate General. This is a rather unusual step for a preliminary ruling. Why did the Court choose to be so much more activist? While it is impossible to look into the judges’ minds, looking at the effects of the Court’s decision might shed some light on the Court’s motives.

By establishing the principle of equal access, the *Spector* Court has created a source of law which it can resort to when there is a need to fill gaps in the Market Abuse Directive, that is, whenever a legal question arises for which the Market Abuse Directive does not provide an explicit or easy-to-find answer. While the ECJ’s ruling does not by itself broaden the scope of application of the Market Abuse Directive, it is likely to enlarge the total sum of issues of national securities law that have to be interpreted in the light of the Market Abuse Directive. In summary, by establishing equal access as the guiding principle of the Market Abuse Directive, the ECJ has created a lever which enables it to review more decisions of national courts within the scope of the Market Abuse Directive.

However, it is important to note that the principle of equal access is not merely a stratagem of the ECJ to displace European legislators in the final say over what constitutes market abuse. Instead, the content of the principle of equal access must be deduced from the rules and value judgments contained in the Market Abuse Directive itself (and probably its Level-2 implementations as well). Still, since the ECJ did not provide an exhaustive definition of exactly is meant by “equal access”, there is legal uncertainty as to how the ECJ will use the room available to it to shape the law arising under the Market Abuse Directive.⁴¹ This might be an incentive for the Commission to initiate some Level-2-regulation, clarifying when exactly there is “use of inside information” as defined in Art. 2(1) MAD.

c) A Methodological Critique

The foregoing analysis of the concept of equal access provides a basis for a methodological critique of the *Spector* decision.

First, with respect to the *Spector* exception, the Court has created *standard*, although a *rule* would have sufficed and made more sense.⁴² The standard created by the court is the notion that only an “unfair” informational advantage, that is, only usage which goes against the purpose of providing equal access, constitutes the insider trading prohibited by Art. 2(1) MAD. Creating this standard was not necessary to answer the referring courts questions. It would have sufficed to simply state that acquiring or disposing of shares in possession of inside information implies that there is a “use” of information subject to the right of defence and, in particular, rebuttal by showing that the information did not influence the investment decision. Such a rule, as proposed by the Advocate General, would have made more sense because, as a general matter, standards create more legal uncertainty. This seems especially harmful in the context of European securities regulation because the transactions in which this legal uncertainty is relevant occur frequently all over Europe and it might take a long time for the ECJ to clarify the issues left open by the *Spector* decision.

⁴¹ Some of the most urging issues will be examined *infra* II)3).

⁴² For the some of the most fundamental insights into the theory of rules and standards see D. Kennedy, Form and Substance in Private Law Adjudication, 89 Harvard Law Review 1685 (1976); P. Schlag, Rules and Standards, 33 UCLA Law Review 379 (1985); A. Scalia, The Rule of Law as a Law of Rules, 56 University of Chicago Law Review 1175 (1989); L. Kaplow, Rules versus Standards: An Economic Analysis, 42 Duke Law Journal 559 (1992). For a recent account of the role of rules and standards in securities regulation see K. Alexander, Principles v. Rules in Financial Regulation: Re-assessing the Balance in the Credit Crisis Symposium at Cambridge University, 10 European Business Law Organization Review, 169 (2009); S.L. Schwarcz, The ‘Principles’ Paradox, 10 European Business Law Organization Review, 175 (2009).

Second, the Court has created a *general* standard although a *particular* rule defining the exception would have sufficed and made more sense.⁴³ The generality of *Spector*'s standard reflects the fact that the Court tries to "kill many birds with one stone", that is, tries to answer the general question which trading in possession of inside information is not prohibited. This was not necessary to answer the referring court's questions. Apart from that, it does not seem to be good regulatory policy because it is this aspect in which the *Spector* decision departs from the securities laws of other countries.⁴⁴ It is also questionable whether all the exceptions to be found in the Market Abuse Directive (and its implementations) can be traced back to the principle of equal access. Take, for example, the exception for market makers, which is expressly mentioned by the Court. It does not seem that this exception can be explained on the grounds of equal access or that market makers are necessary to establish investor confidence. Rather, it seems that market makers are granted privileged access to some inside information as consideration for their services, in the form of a fee paid by the overall market because this payment structure reduces the overall transaction costs in secondary markets.

Overall, the fact that the Court establishes a standard without defining its content but merely pointing at some express rules and judgments to be found in the Market Abuse Directive might actually deprive the *Spector* exception of all the merits that a standard usually has. To quote from a seminal article by *Duncan Kennedy*: "One characteristic mode of ordering a subject matter area including a vast number of possible situations is through the combination of a standard with an ever increasing group of particular rules (...). The generality of the standard means that there are no gaps: it is possible to find out something about how judges will dispose of cases that have not yet arisen. But no attempt is made to formulate a formally realizable general rule. Rather, case law gradually fills in the area with rules so closely bound to particular facts that they have little or no precedential value"⁴⁵. This is exactly what could be the fate of the *Spector* exception.

3) The Dogmatic Perspective

The methodological critique raises urgent dogmatic issues. The *Spector* decision leaves open questions which will be highly important to practitioners in Europe.

⁴³ For the distinction between general und particular rules and standards see D. Kennedy, 89 Harvard Law Review 1685, 1689 et seq. (1976)

⁴⁴ *Supra* II)1)b).

⁴⁵ Duncan Kennedy, 89 Harv. L. Rev. 1685, 1690 (1976).

a) The Principle of Equal Access

The most important dogmatic issue is to understand and to apply the principle of equal access. As the ECJ indicates in the *Spector* decision, this was the core principle of the Insider Trading Directive and guided both the ECJ's *Georgakis* and *Grøngaard* decisions⁴⁶. Its roots can be traced back to the origin of European securities regulation, the Segré-report of 1966.⁴⁷ The Market Abuse Directive is not expressly based on the principle of equal access.⁴⁸ However, as the ECJ shows, this principle can be drawn from the Market Abuse Directive's second and twelfth recitals, its genealogy, its concept of inside information and the directive's purpose to protect investor confidence.⁴⁹ In the United States, market egalitarianism was the basis of the landmark decision *SEC v Texas Gulf Sulphur*⁵⁰ and the often-cited SEC-decision *Cady, Roberts and Co.*⁵¹, the first SEC decision to address insider trading on the open market. The later Supreme Court ruling in *Chiarella*, however, rejected it as a rationale for the insider trading prohibition.⁵²

Investor egalitarianism under EU securities law could have three aspects.⁵³ First, there seems to be an aspect of "geographic" equality in the concept of equal access, that is, investors from different member states should have equal access to price-relevant information (see, e.g. Art. 12 of Directive 2007/14/EC). Second, there could be an aspect of "professional" equality, under which no class of investors – such as professional investors – shall have privileged access to information [see, e.g. Art. 6(3) MAD]. This aspect of equality might again be divided into a rule of "chronological" equality ("No investor shall have access to inside information before the other") and "substantive" equality ("Inside information is to be published in a fashion that both professional and retail investors are able to understand").

Note, however, that market egalitarianism is a principle of formal equality and not of material equality: European securities regulation can only be about giving investors equal access, *i.e.*, equal opportunity, to exploit relevant information, and need not about ensuring that investors

⁴⁶ ECJ, Case C-391/04 *Georgakis* [2007] ECR I-3741, para. 38; EJC, Case C-384/02 *Grøngaard & Bang* [2005] ECR I-9939, para. 33; see also Moloney, *EC Securities Regulation*, 2nd Ed. 2008, p. 925 n. 57.

⁴⁷ Report of a Group of Experts appointed by the EEC Commission, *The Development of a European Capital Market*, 1966, p. 249.

⁴⁸ Moloney, *EC Securities Regulation*, 2nd Ed. 2008, p. 942

⁴⁹ This had also been the predominant view in European securities law scholarship, see, e.g., G.A. Ferrarini, *The European Market Abuse Directive*, 41 *Common Market Law Review* 711, 723 (2004); J. Lau Hansen, *MAD in a Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive*, 15 *European Business Law Review*, 183, 192 (2004); Moloney, *EC Securities Regulation*, 2nd Ed. 2008, p. 925.

⁵⁰ 401 F.2d 833, 848 (2d. Cir. 1968).

⁵¹ 40 SEC 907, 912 (1961).

⁵² *United States v. Chiarella*, 445 U.S. 222, 232 (1980); see also R. Kraakman in K.J. Hopt/E. Wymeersch (eds.), *European Insider Dealing*, 1991, p. 39, 40-42.

⁵³ This issue will be examined in more detail *infra* II(3)b)cc).

will actually be able to exploit such information equally. Excluding material equality follows from the simple fact that such equality is impossible to achieve as some traders have better equipment and superior abilities to interpret price-relevant information.⁵⁴ This limit to equality should not be troubling because in efficient markets investors are “price-protected”. They benefit from the better-informed traders’ efforts to exploit information by getting a “fair” price for their securities.⁵⁵ One important general question of the principle of equal access is whether market efficiency can actually *substitute* completely equal access among investors. This question will be revisited below.⁵⁶

b) The Market Abuse Directive “in the light” of the principle of equal access

For practitioners, even more important than understanding the principle of equal access in general are the questions (a) what is the scope of this principle, that is, which provisions of the Market Abuse Directive will have to be interpreted “in the light” of this principle, and (b) what will be the impact of this principle on the interpretation of the Directive. The remainder of this paper gives a short overview of what are likely to be the most pressing questions.

aa) “Using” Inside Information

The essence of *Spector* is to apply the principle of equal access when deciding whether a primary insider in possession of inside information “used” that information as defined in Art. 2(1) MAD. Unfortunately, the ECJ does not provide a full answer to the question of when exactly there is an “unfair” use of inside information which contravenes the purpose of the Market Abuse Directive. Instead, the *Spector* Court provides a “roadmap” for national courts and practitioners on how to make this distinction. Based on the express rules and judgments of the Market Abuse Directive, it seems likely that the Court would refuse to qualify the following cases as insider trading under Art. 2(1) MAD.

(a) Trading when there is no causal link between the possession of the inside information and the transaction

When there is no causal link between the possession of an inside information and the transaction, there is no exploitation of that information and hence no reason to prohibit the

⁵⁴ V. Brudney, *Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 360 (1979); R.J. Gilson/R. Kraakman, *The Mechanisms of Market Efficiency* 70 Va. L. Rev. 549, 571 (1984).

⁵⁵ Cf. F. Easterbrook/D.H. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Virginia Law Review 669, 694 (1984)

⁵⁶ *Infra* II(3)b)bb) and II(3)b)cc).

trade. No other market participant has to fear such trades by in the future because – by definition – its arrangements have been made before the inside information becomes known. Accordingly, Art. 2(3) MAD provides that the insider trading prohibition shall not apply to transactions conducted in the discharge of a current obligation to acquire or dispose of financial instruments where that obligation results from an agreement concluded before the person concerned possessed inside information. The classical example is the acquisition of shares according to a fixed trading plan after the investor has learnt some inside information, which is expressly mentioned as an exception of the insider trading prohibition in other securities regulation regimes.⁵⁷ Furthermore, as the Advocate General mentions, there is no “use” of information when the insider actually trades against the impetus of this information, *e.g.*, disposes of his shares because he is in financial distress even though he has learned of some confidential good news that will lead to a price increase when it becomes public.⁵⁸

A decisive question in these cases is who has to prove that there was no causal link. *Spector* shifts this burden to the primary insider in possession of inside information. This raises the question of what standards to apply when deciding whether the presumption has been rebutted, especially whether it is permissible to apply a lower threshold for meeting the exculpatory burden in criminal proceedings than in administrative proceedings.⁵⁹

The Court justifies its shift of the burden to the defendant generally on the grounds, among other reasons, that any additional subjective requirement beyond the possession of the inside information, would impede the effectiveness of the insider trading prohibition and therefore the harmonisation of European secondary markets regulation.⁶⁰ This could mean that the Court wants the same standard applied in criminal and administrative proceedings. That approach has support in the ECJ’s holding in the *Grøngaard & Bang* case, namely, that the interpretation of the scope of a directive cannot depend on the civil, administrative or criminal nature of the proceeding in which it applies.⁶¹

On the other hand, the question about what is necessary to rebut the presumption of insider trading can also be understood as being part of the law that governs *the sanctions* of insider trading. Taking into account that the Court in *Spector* is very hesitant to give instructions with

⁵⁷ For the United States see Securities Exchange Act Rule 10b5-1; for New Zealand see s. 10C Securities Markets Act.

⁵⁸ AG Kokott Opinion, C 45-08 *Spector Photo Group NV*, para. 67.

⁵⁹ J. Lau Hansen (n. 39) sub. 4.3.

⁶⁰ para. 33.

⁶¹ EJC, Case C-384/02 *Grøngaard & Bang* [2005] ECR I-9939 para. 28.

regard to a national sanction system,⁶² it should be tolerable to grant defendants in criminal proceedings a better opportunity to rebut the presumption than in administrative proceedings.⁶³ This is underlined by the fact that the Court bases the necessity of an opportunity to rebut the presumption of Art. 2(1) MAD on the principle of the presumption of innocence laid down, *inter alia*, in Art. 6(2) ECHR. These rights may be stronger when there is a threat of criminal sanctions, even though this might impede the effective and uniform application of EU law, a notion which the ECJ acknowledged in *Grøngaard & Bang* as well.⁶⁴

Two qualifications, however, apply. First, this differentiation can only apply with respect to the factual requirements of rebuttal. National courts cannot be more generous with defendants in criminal proceedings than in administrative proceedings when it comes to exculpatory arguments based on legal grounds, for this would mean a different interpretation of the law. Second, as far as the Market Abuse Directive is concerned, national courts cannot apply the opportunity to rebut the presumption so generously that it actually becomes the rule, as this is clearly not what the ECJ has intended.

(b) Trading on the same basis of information

When people trade on the same basis of information, that is, when both parties to a transaction possess the same inside information, there is no inequality and thus there should be no insider trading. Therefore, the Court's finding in *Georgakis* – a case decided under the ISD – should still be valid.⁶⁵ In this respect the EU law would not be unique. The detailed New Zealand insider trading regulation provides a special “trading on the basis of equal information” defence.⁶⁶

(c) Outsider trading

As the language of the Court's preliminary ruling is limited to primary insiders⁶⁷ the question arises whether the Court would apply the same principle to an outsider who is in possession of inside information and knows or ought to have known that it is inside information (so-called

⁶² para 71: “It must be noted that Article 14(1) of Directive 2003/6 does not establish any criteria for assessing how effective, proportionate and dissuasive a sanction is. It is for national legislation to define those criteria”.

⁶³ Cf. J. Lau Hansen (n. 39) sub. 4.3.

⁶⁴ EJC C-384/02 *Grøngaard & Bang* [2005] ECR I-9939 paras. 29 and 30.

⁶⁵ J. Lau Hansen (n. 39) sub. 4.5; see also D. Moalem & J. Lau Hansen, Insider Dealing and Parity of Information – Is *Georgakis* Still Valid, 19 *European Business Law Review* 949 (2008).

⁶⁶ s. 10B Securities Markets Act: „it is a defence if (the defendant) proves on a balance of probabilities that the opposite party to the transaction knew, or ought reasonably to have known, the same inside information (...) before entering into the transaction”.

⁶⁷ para. 62: „a person as referred to in the second subparagraph of (Art. 2 of the Market Abuse Directive)”.

secondary insider). The wording of the Market Abuse Directive seems to provide a quick answer. Art. 4(1) MAD requires member states to ensure that Art. 2 MAD applies to any other person who possesses inside information and knows or ought to have known that it is inside information. Since those persons are treated like primary insiders, it seems to follow that the same standard should apply when deciding whether these persons used the inside information. This result is supported by the notion that the *Spector* rule follows, among others, from the nature of the inside information. Since inside information is price relevant by definition, it seems justified to presume that a person in possession of this information who bought or sold securities used that information.⁶⁸ This applies equally to both primary and secondary insiders.

This makes it all the more notable that the *Spector* Court expressly confines its ruling to primary insiders,⁶⁹ whereas the AG proposed to extend the presumption to secondary insiders⁷⁰. Also, the underlying notion of the ECJ's interpretation of Art. 2(1) MAD, the principle of equal access, makes the answer more complicated. That is because market egalitarianism as the rationale for the insider trading prohibition makes much more sense when applied to primary insiders than when applied to secondary insiders. Primary insiders possess inside information as a result of discharging a duty for the issuer or a criminal act [Art. 2(1)(2) MAD]. In essence, they misappropriate information. In contrast, outsiders who are not tippees⁷¹ might actually *produce* new inside information as defined by Art. 1(1) MAD by using their analytical skills and knowledge. Discouraging these traders from using their knowledge by imposing on them a rule of "disclose or abstain" might harm market efficiency, whereas similar effects are not likely with regard to primary insiders.⁷² The Market Abuse Directive recognizes this notion by stating in Recital 31:⁷³

⁶⁸ para. 36; see also J. Lau Hansen (n. 39) sub. 4.1.

⁶⁹ para. 62.

⁷⁰ AG Kokott Opinion, C 45-08 *Spector Photo Group NV*, para 108: „Article 2(1) of Directive 2003/6 should be interpreted as meaning that the fact that a person possesses inside information which he knows, or ought to have known, constitutes inside information and acquires or disposes of financial instruments to which that inside information relates as a rule signifies in itself that he ‘makes use’ of the information”.

⁷¹ Under European law getting a „tip“ from a primary insider is not required to be qualified as secondary insider; see e.g. G.A. Ferrarini, 41 *Common Market Law Review* 711, 723 (2004).

⁷² Brudney, 93 *Harvard Law Review* 322, 339-343 (1979); K.E. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 *Journal of Legal Studies* 801, 812-814 (1980). The economic foundations of this notion can be found in J. Hirshleifer, *The Private and Social Value of Information and the Reward to Incentive Activity*, 61 *American Economic Review* 561 (1971) and A. Kronman, *Mistake, Disclosure, Information, and The Law of Contracts*, 7 *Journal of Legal Studies* 1 (1978).

⁷³ The ECJ also seems to acknowledge that outsider trading might be treated differently by referring to Recital 18 MAD and stating that “the assessment of what a reasonable person knows or should have known (with regard to Art. 4 of the Market Abuse Directive) ,in the circumstances’ is to be carried out by the competent authorities.

“Research and estimates developed from publicly available data should not be regarded as inside information and, therefore, any transaction carried out on the basis of such research or estimates should not be deemed in itself to constitute insider dealing within the meaning of this Directive“.

The question is whether the notion implicit in Recital 31 of the Market Abuse Directive can be captured in any workable rule, providing outsiders with a special “*Spector* defense”. From a Law & Economics perspective it seems more accurate to speak of an unjust information advantage of outsiders only in cases in which the public is unable to lawfully overcome or offset the insiders’ advantage.⁷⁴

(d) Other specific situations

As the ECJ mentions, the Market Abuse Directive contains notions that the insider trading prohibition shall not apply under special conditions or circumstances such as the preparation of a takeover bid and with respect to market makers, bodies authorized to act as counterparties or persons authorized to execute orders on behalf of third parties (cf. MAD Recitals 18, 29, 30). As the ECJ merely recites the wording of the MAD-recitals in the *Spector* decision, it is uncertain where exactly to draw the line between legitimate actions and insider dealing.⁷⁵

bb) When is an Inside Information Known to the Public?

As the ECJ mentions in *Spector*, the notion of market egalitarianism is closely linked to the Market Abuse Directive’s definition of inside information.⁷⁶ Therefore it seems likely that the Court will apply the principle of equal access to questions revolving around the concept of inside information as well.

With regard to the principle of equal access, the question arises when exactly inside information becomes “publicly known”. If “the essential characteristic of insider dealing (...) consists in an unfair advantage being obtained from information to the detriment of third parties who are unaware of it”⁷⁷, it should *not* be decisive whether one party knows inside information which the other party does not know, but whether this party *can exploit the information* to the detriment of the counterparty. Thus, information would be “publicly

⁷⁴ Brudney, 93 Harvard Law Review 322, 360 (1979).

⁷⁵ For an assessment of German law after the Advocate General’s opinion see Cascante & Bingel, Ist “Nutzung” mehr als “Kenntnis”?, Die Aktiengesellschaft 2009, 894.

⁷⁶ para. 50: „Consequently (...)“.

⁷⁷ para. 52.

known” if either it has been made publicly available or if it has already been factored into the price and therefore cannot be exploited by just one (price-taking) party. On this view, it could suffice for an alleged insider to show that the relevant information had already been known to a group of traders whose transactions moved the price of the security in proportion to its informational value, thus factoring it into the price and indirectly making the information publicly available. In US insider trading law both approaches have been suggested.⁷⁸

cc) **How to Disclose Inside Information?**

The question of when information is publicly known is closely connected with the question of how to disclose inside information directly concerns an issuer under Art. 6(1) MAD. While Art. 6(2) MAD merely provides that issuers must post such information on their website for an appropriate period, the details of disclosure are governed by another rule, Art. 21 of Directive 2004/109/EC⁷⁹ (“Transparency Directive”). That provision states that all regulated information – of which inside information is a part [Art. 2(1) lit. k of the Transparency Directive] – must be disclosed in a manner ensuring fast access to such information on a non-discriminatory basis and made available to a mechanism officially appointed by the member states. This provision is implemented by Art. 12 of Directive 2007/14/EC which states that regulated information shall be disseminated in a manner ensuring that it is capable of being disseminated to as wide a public as possible and as close to simultaneously as possible in the home Member State.

These provisions expressly establish a principle of geographic equality in access to information. The question that *Spector* raises is whether, at least for the disclosure duties under the Market Abuse Directive, there is also a principle of professional equality, *i.e.*, whether inside information must be equally accessible by both professional and retail investors. As indicated before⁸⁰, this issue has two aspects, chronological and substantive equality. The first is the question of whether after *Spector* there has to be strict chronological equality in access between professional and retail investors or whether it suffices to disseminate inside information through a system which is primarily accessible by professional

⁷⁸ The classical case favouring a public access approach is *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 854 (2d Cir. 1968); the market price approach has been suggested in *United States v. Libera*, 989 F.2d 596, 601 (2d Cir. 1993).

⁷⁹ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390/38.

⁸⁰ *Supra* II)3)a).

market participants (such as the German concept of *Bereichsöffentlichkeit*⁸¹). The second aspect is the question of whether disclosure of inside information has to be formulated in a fashion which minimizes advantages of professional traders over retail traders with regard to knowledge and interpretability.

The answer to these questions again depends on the exact concept of market egalitarianism. If the concept is taken literally, issuers should be obligated to minimize any professional discrimination. If an efficient market (*i.e.*, a fair price) is thought to provide market egalitarianism, professional discrimination could be tolerable or even desirable. On the latter view, favouring professional traders over retail investors could increase the overall equality in access to information because prices could adjust quicker to fundamental changes as, for example, issuers could be more willing to disclose sensitive information which requires sophisticated interpretation to professional market participants than to retail investors.⁸² While the *Spector* Court did not give any hints on how to solve this issue, the goal of EU securities regulation to achieve a retail investment culture [*see, e.g.*, Art. 6(3) MAD] seems to indicate the former answer as more likely to be adopted by the ECJ in some future decision.⁸³

III) Conclusion/Summary

In *Spector* the ECJ bases the decision whether a primary insider in possession of inside information “used” that information within the meaning of the insider trading prohibition of the Market Abuse Directive on the principle of equal access (market egalitarianism). This paper provides a comparative, methodological and dogmatic critique of the Court’s ruling, arguing that the Court should have exercised more judicial self-restraint. First, while the principle of equal access can be derived from the wording, genealogy and purpose of the Market Abuse Directive, it does not seem likely that it is the underlying notion of every exception to the insider trading prohibition. Second, the *Spector* exception provides a general standard for answering a question which would have better be governed by a specific rule. Finally *Spector* leaves significant issues open for debate, including (1) what exactly are the aspects of equal access under European securities regulation (geographic, chronological, substantive), (2) does the principle of equal access as defined by *Spector* apply without

⁸¹ See H.-D. Assmann in H.-D. Assmann/U.H. Schneider (eds.), *Wertpapierhandelsgesetz*, 5th Ed. 2009, § 14 n. 34 et seq for an overview.

⁸² Cf. D. Langevoort, Taming the Animal Spirits of Stock Markets: A Behavioral Approach to Securities Regulation, 97 Nw. U. L. Rev. 135, 164 et seq (2002) (summarizing some of the arguments which had been made by opponents of SEC Regulation Fair Disclosure).

⁸³ Cf. Moloney, *EC Securities Regulation*, 2nd Ed. 2008, p. 968.

modification to outsider (= secondary insider) trading, (3) to what extent can equality in access be provided (or substituted) by an efficient market?