The Market Abuse Regulation (596/2014/EU) and the Market Abuse Directive (2003/6/EC) – A non-financial company's buy back of own shares constituted market manipulation

On 23 March 2017, the Danish High Court Eastern Division (Østre Landsret) delivered its judgment in one of the most high-profiled cases on market manipulation against the Danish company Parken Sport & Entertainment A/S (**Parken**), its former chair and its former chief executive officer (CEO). By increasing the sentence decided by the lower court's judgment, the High Court sent a clear message that market manipulation is not to be tolerated.

Regulation (EU) No 596/2014 on market abuse (**MAR**) entered into force on 3 July 2016 replacing both Directive 2003/6/EC on insider dealing and market manipulation (**MAD**) and certain provisions of the Danish Securities Act (**DSA**), that constituted the national implementation of MAD. By virtue of its legal status as an EU-regulation, MAR has direct effect.[1]

As to the case concerning Parken, this change in the legal framework entailed that the High Court's and lower court's judgments were delivered on two different legal statutes. The lower court's judgment was delivered on the basis of DSA (and MAD), whereas the High Court's judgment was delivered on the basis of MAR – which currently is the prevailing legislation.

Transitional criminal law

The Danish Criminal Code section 3 lays down as a fundamental principle; "*if the criminal legislation in force at the adjudication of an act differs from the legislation in force when the act was committed, the issues of criminality and penalty must be decided under the most recent statute, provided always that the decision may not result in a more severe sentence that the sentence imposable under the former statue*."

In general, MAR aims to increase market integrity, improve investor protection and ensure that market abuse is clearly prohibited.[2] Concerning the prohibition on market manipulation, compared to MAD, MAR stipulates a number of clarifications, elaborations and changes. However, the scope in the prohibition in MAR and MAD is the same. Relevant for this article is to examine how the High Court interpreted market manipulation in relation to a non-financial company's buy back of own shares and to identify if MAR differs from MAD. Only differences of relevance for this problem will be commented upon.

According to the High Court, the articles in MAR regarding market manipulation of relevance to the Parken-case did not provide for a limitation in the interpretation of market manipulation compared to MAD. Pursuant to section 3 in the Danish Criminal Code, the conduct in the Parken-case must fulfil the requirements of actus reus in DSA (and MAD) as

[1] Pursuant to article 288 in the Treaty of Lisbon.
[2] MAR preamble whereas clause 8.

well as those of MAR. Consequently, the High Court's judgment takes into account both the provisions in DSA (and MAD) and in MAR.

The Parken-case

In its judgment of 8 September 2015, the lower court (Københavns Byret), found the two main actors, the former chair and the former CEO, guilty of manipulation in connection with a series of share buy backs and they were passed a sentence of suspended prison of respectively 4 and 6 months, and a confiscation of DKK 0 and DKK 20,000. In addition hereto, Parken as a company was submitted to a fine of DKK 1,000,000. In Danish criminal law, a legal person may be subject to criminal sanctions in the form of fines and the company was consequently a defendant as were its officers.

In the High Court's judgment of 23 March 2017, the penalty was increased substantially. The prison sentence was no longer suspended and the length was increased for both defendants to 1½ year. The confiscations were increased from DKK 0 to 800,000 and from DKK 20,000 to 9,000,000. As for Parken, the fine was increased to DKK 13,000,000.

The case is unique and of general public interest, in particular due to the fact that it concerns a non-financial limited company. Previous cases on manipulation have concerned financial institutions, where buy backs can be justified through other considerations, since shares in financial institutions like banks are often used in connection with saving accounts. The recent Financial Crisis provoked a string of manipulation cases concerning banks, some ended in conviction while others ended in acquittal. But the Parken-case was the first major case of a listed non-financial company charged with manipulation for buying back its own shares.

The beginning of the case

The case was initiated by an article published in a Danish economic weekly, which attracted the attention of the Danish Stock Exchange (Nasdaq Copenhagen), which requested Parken to account for their buy back of own shares. Simultaneously, the Danish Financial Supervisory Authority was notified, which in 2010 resulted in a report to the Public Prosecutor for Special Economic Crimes (SØIK, hereafter the **Prosecutor**). In 2013, Parken and its chair and CEO were indicted for market manipulation. According to the indictment, Parken had manipulated the share price in connection with buying up almost 100,000 own shares on the Nasdaq Copenhagen through two investment banks in the period from 12 November 2007 to 24 October 2008.

The pivotal point of the case was whether Parken's buy backs could be justified by virtue of the need to fulfil legal obligations, or whether the conduct constituted market manipulation.

This article primarily focuses on the High Court's judgment. Only when relevant, will the lower court's judgment be included.

Parken's purpose for buying up own shares

Parken bought its own shares partly to use the shares as means of payment with reference to commercial activities with third parties, partly for hedging its option programmes for the management and senior executives. However, according to the Prosecutor, these purposes were only a part of Parken's buy back strategy – the reason why Parken was indicted for market manipulation. The indictment was based on two counts. The first count concerned the period from 12 November 2007 to 1 August 2008 (almost 9 months) (subdivided into three periods), whereas the second count was divided into 49 subcounts and was related to the period from 13 August 2008 to 24 October 2008 (approx. 3 months).

The challenge of drawing a clear line in order to determine whether a share price has been manipulated seems substantial, since every order and transaction will have a price-influencing effect. That, after all, is how the market price is generated. Therefore, to a certain extent, the actor's intention must be taken into account.[3] Bearing that in mind, the question to be asked in order to distinguish legal from illegal behaviour is whether a market actor is trading shares hoping that the price will rise, or whether the trading is conducted to deliberately affect the share price (often for personal or other financial gain). This general view and in some way banal approach seems to be the approach the High Court concurs in determining the scope of manipulation in the Parken-case.

Parken's strategy and need for shares

The High Court acknowledged that a market actor is allowed to buy back own shares provided the market actor has a legitimate need for these own shares e.g. when legal obligations are to be fulfilled. The High Court also acknowledged that Parken – by virtually all its trades – had such a need. However, the High Court stated that Parken also pursued other general purposes in connection to the buy backs. As to general purposes – besides legal obligations – the High Court emphasized that Parken's strategy: 1) was to keep liquidity in the stock, and 2) to keep the price stable and make sure the price did not fall below or rise above certain price levels.

Furthermore, the High Court took into account that Parken's need for own shares, in order to fulfil the legal obligations, did not play a decisive role in the buy backs. This was supported by: 1) telephone conversations and e-mail correspondences in the trading

[3] As examples of manipulative behavior, it is stated in the Commission's delegated regulation (EU) 2016/522 of 17 December 2015 (supplementing Regulation (EU) No 596/2014), Annex II "Indicators of manipulative behavior" Section 1, subsection 5, litra d*: "Buying or selling of a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances, deliberately, at the reference time of the trading session (e.g. opening, closing, settlement) in an effort to increase, to decrease or to maintain the reference price…"* and subsection 6, litra a*: "Entering of orders which are withdrawn before execution, thus having the effect, or which are likely to have the effect, of giving a misleading impression that there is demand for or supply of a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances at that price — usually known as 'placing orders with no intention of executing them".*

periods, where especially Parken's CEO on several occasions – when placing orders to the investment banks – clearly expressed that the price should be stabilised at certain levels or closed at certain prices, 2) the Parken-share's closing price by the end of the year 2007 – Parken had a trade agreement with a third party, which was why Parken wanted to keep the share price at a high level, because the third party was to buy 50,000 shares in the beginning of 2008, 3) events in the fall of 2008, when instructions to keep the price at certain levels were given, most likely in order to send healthy signals to the market, 4) Parken's behaviour in the closing auctions held by Nasdaq Copenhagen, where Parken was price-leading[4] in a substantial part of the trades, just as Parken was accountable for almost the entire revenue in the Parken-share and 5) that Parken did not buy shares at the cheapest possible price, which according to the CEO otherwise was his strategy, although it did not fit with the facts described in bullet 1-4.

Information to the market

As far as information to the market was concerned, the High Court held that the relatively scanty amount of information with which Parken provided the market, i.e. Parken's *historical* accounting information, neither isolated nor in conjunction with Parken's stock exchange announcements regarding option programmes and information in terms of (chosen) commercial activities, constituted adequate information to the market in terms of character, dimensions or scope of Parken's buy back activities. In connection hereto, the High Court emphasized that the market was not supplied with information concerning a specific and significant commercial activity. Providing the market with (updated and correct) information is deemed important, because the omission to inform creates an asymmetrical level of information and thereby increases the risk of a manipulated/incorrect share price.

Additionally, the High Court attached importance to the fact that the market had not been informed of Parken's strategy as to creating liquidity in the Parken-share and Parken's strategy of keeping the price at certain levels. It may be considered whether the Prosecutor would have pursued the matter, had Parken informed the market about its intention to support the price and to increase/create liquidity in the Parken-share. Since the essence of market manipulation is deception of the market, is it at all possible to manipulate, if the market is fully informed about a market actor's strategy when buying own shares? Theoretically, probably not. Practically, it does not seem of particular relevance, as no deceiving actor has an interest in revealing a (probably illegal)[5] strategy.

MAR article 12, litra a (ii) (former DSA section 38, subsection 1 (4) and DSA article 1 (2), litra

[4] According to the Prosecutor, a price-leading position is defined by overbidding other buyers, trading at best offer prices and trading at higher prices than the share was last traded.
[5] It is debatable if creating liquidity in the share when buying own shares is a legitimate purpose. However, it does not seem to be the case, if the buy backs exceed the scope in the buy-back programmes.

a, second paragraph)

Article 12, litra a (ii) is infringed when an operator has a dominant position in the market and uses this position to exploit the market by securing the price at a certain level, e.g. by creating a floor or a ceiling in the price pattern.

In its judgment, the High Court held that Parken – by virtue of a massive presence and substantial number of trades in the Parken-share, which constituted a significant part of the revenue, including also in the closing auctions – obtained a dominant position over the demand of the stock. Furthermore, Parken – to a great extent – took a price-leading position in the market. Combined with Parken's strategy, cf. above, one of the general purposes being to support the price, and combined with the development in the share price compared with other selected stock indexes (Mid Cap, C20 and CX25), the High Court established it to be proven that the Parken-share was at an incorrect, false and fixed price level. This constituted an infringement of MAR article 12, litra a (ii).

As to the question of whether Parken's trade orders and behaviour were "able"[6] to affect the price, there was a discrepancy in the High Court's and the lower court's apprehension. The lower court found that a bid below the market price[7] were not "able" to affect the price in a way that deviates from the stock's value in the market. One might wonder how the lower court can arrive at this conclusion considering that the very heart of market manipulation for a market actor with a dominant position encompasses a behaviour, which creates a floor or a ceiling in the price pattern.

This illustrates that presumably unambiguous legislation does not always mean that the legal status is clear. In some cases, the rules regarding market manipulation seem difficult to link to a specific behaviour.

MAR article 12, litra a (i) (former DSA section 38, subsection 1 (2) and DSA article 1 (2), litra a, first paragraph)

Article 12, litra a (i) is infringed when special circumstances of a certain activity gives, or is likely to give, false or misleading signals as to the supply of, demand for or price of a stock to the market.

For the same reasons as mentioned above and with reference to the High Court's comments on Parken's information to the market, the High Court held that the bids and trade orders constituted an infringement of MAR article 12, litra a (i).

[6] The word *able* – in Danish "*egnet/egnede"* – was used in the DSA but is of Danish origin and predates the implementation of MAD. Although it does not appear in MAD, it was maintained since it was seen as implementing the 'effect doctrine', that manipulation is deemed to take place where a transaction is 'able' to have a manipulative effect. Now, where MAR is applicable, the wording is no longer relevant, but it was considered by the High Court, which found that MAR did not provide a less strict regime than MAD in this respect.
[7] The price at which the share was last traded.

Conclusion

The commencement of MAR sets a clean slate in terms of national case law – the reason being that neither the EU-Commission nor the European Court of Justice are bound by national case law.

Until there are new rulings concerning market manipulation constituting a specific case law based on MAR, the national courts will most likely lean towards existing national case law and the interpretation of national legislation (as well as MAD) in determining whether a given conduct constitutes a lawful or unlawful behaviour.

The Danish High Court's interpretation of the prohibition of market manipulation laid down in MAR seems – in the bigger picture – to be within the same scope as stipulated in MAD in relation to the Parken-case. So, what is the outcome of the Parken-case?

In Denmark, civil and criminal court cases are subject to appeal only once. Consequently, appeal of the High Court's judgment was possible only upon request to the Court Administration, an independent public authority in charge of the courts, which would require either that the judgment relies on a wrong interpretation of the law or that the outcome is unclear compared to other case law and of major public interest. The Court Administration, however, rejected appeal to the Supreme Court. Thus, the judgment of the High Court was the final word.

Based on an immediate consideration, the High Court's judgment – being the only one concerning a non-financial company – seems to establish the current state of law. However, that is not necessarily correct. According to the Danish legal philosopher Alf Ross, current law is an expression of the grounds, on which a judge will base future judgments. The more generally the grounds are shaped, the more likely they are to set a precedent and vice versa. In other words, a judgment's precedential value is to some extent defined by whether objective criteria can be inferred.

Even though the judgment appears unambiguous – meaning that the High Court did not hesitate to impose a substantial prison sentence and penalty – it seems fair to allege that the judgment, probably, is only to be ascribed limited precedential value. This is due to the fact that the evident intention of the actors as documented by emails and voice recordings seems to have played a crucial role in the High Court's judgment. As a consequence hereof, it is difficult to derive objective criteria in the attempt of drawing a clear line between legal buy backs of own shares and unlawful manipulation. However, if objective criteria are to be extracted from the judgment, the very price-leading position in the stock during a longer period of time (perhaps in combination with a massive revenue in the stock) will indicate an infringement of MAR article 12 (i) and (ii). Also, the High Court's reference to other relevant stock indexes may perhaps also be qualified as an objective signal.

Having said so, it must be noted that market manipulation is not determined on objective criteria alone. In order to infringe the rules of market manipulation, not only must the actor be responsible for the actual action; the actor should also have perceived that the bid or transaction was susceptible to impact the price on the stock.

Investor protection and integrity are key factors in order to establish efficient financial markets and thereby economic growth in society. MAR aims to secure these key factors. Only the future will reveal how the EU-institutions will do the same through new rulings based on MAR.

Reported by Christian Cold, Bruun & Hjejle.

Editor's note: This report was supervised by Prof JL Hansen, University of Copenhagen. However, only the author is responsible for the opinions expressed in the report.