

Compliance Monitor

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FSA v Jabre – the end of a long saga

On 27 July, the Financial Services and Markets Tribunal announced the FSA's defeat of Philippe Jabre on two preliminary issues. Mr Jabre was former managing director of hedge fund manager GLG Partners LP. The Tribunal's announcement was followed by a statement by the FSA on 1 August that it had fined GLG and Mr Jabre £750,000 each for market abuse and GLG for breaching the FSA's Principles for Businesses. In this article **Simon Orton**, **Oliver Kerridge** and **Miriam Schmelzer** of Freshfields examine the case and its implications for the industry.

Background

On 11 February 2003, Mr Jabre was "wall crossed" by Goldman Sachs as part of the pre-marketing of a new issue of convertible shares in Sumitomo Mitsui Financial Group (SMFG). Mr Jabre was given information about the issue and its intended structure and agreed that he would not deal in SMFG securities until the issue was announced. However, Mr Jabre short sold 4,771 ordinary shares in SMFG over the course of the three days immediately following his conversation with the relevant person at the bank. This short position had a total value of around US\$16 million. When the new issue was announced on 17 February 2003 Mr Jabre made a substantial profit for GLG Market Neutral Fund which he managed.

The proceedings before the RDC

The original Warning Notice issued by the FSA in April 2005 had sought the withdrawal of Mr Jabre's approvals on the grounds that Mr Jabre had committed breaches of Principles 1 (integrity) and 3 (market conduct) of the Statements of Principle for Approved Persons, had deliberately committed market abuse and was therefore not fit and proper. However, the Regulatory Decisions Committee (RDC) in its Decision Notice did not find a breach of Principle 1 or any deliberate market abuse, did not call into question his fitness and propriety and decided not to withdraw Mr Jabre's approvals. Instead, it imposed a financial penalty of £750,000 in respect of a breach of *section 118 Financial Services and*

Markets Act 2000 (market abuse) and for breaches of Principles 2 (due skill, care and diligence) and 3 (market conduct). GLG was found to have committed market abuse contrary to *section 118 FSMA* and breached Principle 5 (market conduct) of the Principles for Businesses. It was also fined £750,000.

The proceedings before the Financial Services and Markets Tribunal

Mr Jabre (but not GLG) decided to appeal the fine to the Financial Services and Markets Tribunal (FSMT). Before the substantive hearing, the Tribunal was asked to rule on two preliminary issues. The preliminary issues to be decided were:

- whether the FSA was entitled to re-introduce, and the Tribunal had jurisdiction to hear, the argument that Mr Jabre's approval should be withdrawn or a prohibition order made against him on the basis that he was not a fit and proper person; and
- whether the selling of shares which took place on the Tokyo market was capable of constituting market abuse under *section 118 FSMA*.

Withdrawal of Approval

In the Tribunal proceedings, the FSA asked the Tribunal to withdraw Mr Jabre's approval and/or prohibit him because it considered that he was not a fit and proper person. This was despite the fact that the RDC had previously rejected this course of action.

Mr Jabre had two main arguments. First, he stated that the reintroduction of the integrity charge was contrary to the aim of FSMA. FSMA requires the FSA to undergo a prescribed process before it can impose a sanction. This includes the issue of a Warning Notice, followed by the individual accused having the right to make representations after consideration of which the RDC issues a Decision Notice, which the individual can then challenge before the Tribunal. If a new charge could be introduced at the Tribunal stage, the fairness of the process would be undermined.

Moreover, under FSMA the FSA is not entitled to refer the case to the Tribunal if it is dissatisfied with the

RDC's decision. The right to refer a matter to the Tribunal is limited to individuals and firms and if they decide not to refer a matter to the Tribunal then the matter is at an end. FSMA could not therefore have been intended to have the effect that the FSA could raise new allegations where an individual exercises his right to refer a matter to the Tribunal. Finally, the decision to reintroduce the integrity charge was clearly calculated to put pressure on Mr Jabre not to exercise his statutory right to refer the matter to the Tribunal.

Second, by *section 133* FSMA the Tribunal has to decide "the matter referred to it" and it was Mr Jabre's position that "the matter" was the RDC's Decision Notice which did not include a finding that he was not a fit and proper person.

The FSA disagreed with this arguing that since FSMA draws a distinction between "matter" and the Decision Notice, "matter" was clearly wider than just the Decision Notice itself. Furthermore, the FSA was not seeking to introduce new facts at this stage but merely asking the Tribunal to decide on the consequences that should flow from the facts that had been set out in both the Warning and the Decision Notices. The FSA also argued that the RDC's decision was essentially an administrative one and the first judicial decision would be made by the Tribunal. Given that the Tribunal would completely re-hear the case, it should be entitled to consider new sanctions.

The Tribunal upheld the FSA's case and stated that it would not be an abuse of process for it to uphold contentions that did not form part of the original Decision Notice as long as the action recommended by it falls within the same Part of FSMA as the action proposed in the original Warning Notice as required by *section 133* FSMA. Such actions comprise prohibition orders, withdrawal of approval, fines and public censures.

The selling of shares on the Tokyo market

Mr Jabre traded in the SMFG shares on the Tokyo market and not London. The FSA considered that the trading could be subject to the UK's market abuse regime given that the shares were also quoted on the London Stock Exchange SEAQ International Trading System.

Mr Jabre's position was that the *section 118* FSMA in force at the time set out that market abuse was "behaviour" in relation to "qualifying investments trading on a prescribed market" and that since the relevant trading took place on the Tokyo market which

was not a "prescribed market" for the purposes of *section 118*, there had been no market abuse.

The Tribunal held that, were it correct, Mr Jabre's argument would produce an "absurd result" and upheld the FSA's position. The wording of *section 118* FSMA has since changed to reflect the implementation of the Market Abuse Directive so, going forward, this point is no longer relevant.

The Final Notice

Following receipt of the FSMT decisions, Mr Jabre decided to withdraw his substantive Tribunal reference accepting the initially proposed fine of £750,000. Given the Tribunal's decision, Mr Jabre was found to have committed market abuse contrary to *section 118* FSMA and breached Principles 2 (due skill, care & diligence) and 3 (market conduct) of the Statements of Principle for Approved Persons. GLG was found to have committed market abuse contrary to *section 118* FSMA and breached Principle 5 (market conduct) of the Principles for Businesses.

In determining whether GLG could be liable for market abuse, the FSA considered Mr Jabre's seniority and status within GLG, the fact that he had authority to enter into the transactions in relation to SMFG shares, the fact that within an agreed overall strategy his dealings were largely unsupervised and that he exercised a large degree of autonomy. The FSA concluded that misconduct on the part of Mr Jabre during the course of his normal duties as manager of the GLG Market Neutral Fund also constituted misconduct attributable to GLG. Mr Jabre's breach of Principle 2 arose from the fact that he had failed to seek advice from GLG's compliance department regarding his actions and he acknowledged that he should have done so.

Although Mr Jabre did not receive a prohibition order, he is not currently an Approved Person and so will have to reapply to the FSA should he wish to hold that status again. On his reapplication, the FSA will have to reassess his fitness and propriety in light of these events.

Commentary

The Tribunal Proceedings

The Tribunal held that the circumstances, evidence and allegations put before the RDC and not the RDC's decision constituted "the subject matter of the reference" for the purposes of *section 133* FSMA. This enabled the FSA to attempt in the Tribunal to impose a prohibition order upon Mr Jabre, banning him from the industry, even though the RDC (the body that makes

the FSA's decisions on what sanction to impose) had earlier rejected a similar charge by the FSA Enforcement Division. The immediate impact of this could be a reduction in the number of appeals to the Tribunal made by individuals, since it is clear that appellants risk receiving tougher sanctions than those originally decided upon by the RDC. However, going forward, the impact is less clear. For example, will this allow the FSA to raise entirely new rule breaches in the Tribunal if they are based on the same facts?

This case also demonstrates how enforcement cases that involve individuals tend to be harder fought, less likely to settle and take longer to resolve than those against firms alone – despite the legal costs involved.

Where Decision Notices have been issued against both a firm and an individual, firms have been likely to accept the RDC's decision whereas individuals have on occasions wanted to refer the matter to the Tribunal because of the relative impact of the proposed sanction on their livelihoods. Until the Tribunal's decision in this case, it will have seemed that there was limited downside risk for an individual in making such a reference. FSA Enforcement cannot refer a case to the Tribunal if they disagree with the RDC's decision, so if the RDC rejected some of the FSA's charges, the individual might think that he could further chip away at the fine in the Tribunal, with limited risk (other than legal costs and the possibility that the Tribunal might increase, rather than decrease, the fine). The Jabre Tribunal decision, however, requires this to be reassessed. It suggests that it may be open to the FSA to reintroduce in the Tribunal additional charges which the RDC rejected. Although the FSA still cannot itself commence an appeal against the RDC's decision, the FSA may be able to reopen parts of the RDC's decision if the individual (or firm) refers the case to the Tribunal. This introduces a potential deterrent to individuals from referring their cases to the Tribunal.

If this militates against making Tribunal references, there is some movement on another front that may encourage some references. At this year's Investigations & Enforcement Conference, Stephen Oliver QC, president of the Tribunal, stated that he was pushing for costs to be awarded against the FSA in a wider variety of Tribunal cases. [1] What effect all of this will have on the number of references by individuals to the Tribunal remains to be seen.

The Final Notice

Mr Jabre's fine of £750,000 is the largest fine that the FSA has levied against an individual. The second

highest fine is £350,000 and was also in respect of a breach of Principle 5 (market conduct, but no finding of market abuse) of the Statements of Principle for Approved Persons.

The Decision Notice in this case was issued by the RDC prior to the Financial Services and Markets Tribunal decision in the Plumber case [2]. In that case, the Tribunal commented that, even had Mr Davidson committed market abuse, the appropriate penalty would have been a censure and not a fine, reasoning that, in cases where there has been cooperation, remedial action is not needed, there is no precedent for a fine and no losses were suffered by investors, no fine should be levied. At this year's Enforcement and Investigations Conference, Tracey McDermott, the FSA Enforcement Department's Head of Litigation and Legal Review, stated that the FSA did not consider itself bound by Tribunal precedent [1].

The Final Notice contains some important points for firms whose employees commit misconduct. It discloses that the FSA's Warning Notice had proposed to fine GLG for breaches of both Principles 3 (systems and controls) and 5 (market conduct) of the FSA's Principles for Businesses and that, following GLG's representations, the RDC decided not to impose a fine upon GLG for failures of systems and controls. GLG was instead fined for breach of Principle 5 and this arose solely from the conduct of Mr Jabre. According to the Final Notice, GLG argued before the RDC that it was wrong to hold the firm liable for breach of Principle 5 on the basis purely of vicarious liability for or attribution of Mr Jabre's conduct, but the RDC did not accept this. This confirms that a firm whose employee commits market abuse could be liable not only for failures of systems and controls (in appropriate cases where its systems or controls were at fault) but also for market abuse (on the basis of its employee's actions).

Notes

1. See 'Half a decade of FSA Enforcement', page 10, *Compliance Monitor* July/August 2006.
2. See 'Knocking in the pipes,' page 1, *Compliance Monitor* June 2006.

Simon Orton (+44 (0) 20 7936 4000, simon.orton@freshfields.com) is a partner in Freshfields Bruckhaus Deringer's Financial Institutions Disputes Group. **Oliver Kerridge** (oliver.kerridge@freshfields.com) and **Miriam Schmelzer** (miriam.schmelzer@freshfields.com) are associates in that group.