Reference numbers: FS/2011/0017
FS/2011/0018

MARKET ABUSE — share price manipulation — whether demonstrated — yes — FSMA s 118 — whether entering into contracts for difference knowing counterparty would hedge by placing orders for stocks amounts to behaviour "in relation to" qualifying investments — yes — whether open to FSA to take action against dissolved Canadian corporation regulated in Canada and with no place of business in United Kingdom — yes — scale of penalty — reference dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

7722656 CANADA INC
(formerly carrying on business as Swift Trade Inc) **Applicant**

- and –

PETER BECK **Third Party**

- and –

THE FINANCIAL SERVICES AUTHORITY **The Authority**

Tribunal: Judge Colin Bishopp
Mr Keith Palmer
Mr Ian Abrams

Sitting in public in London on 11 to 15, 18 to 20 and 22 June 2012

Dr Michael von Pommern-Peglow, counsel, instructed by Ford & Warren, appeared for the Applicant and the Third Party

Mr Timothy Otty QC and Mr Simon Pritchard, counsel, appeared for the Authority.

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DECISION

Introduction

1. On 6 May 2011 the Regulatory Decisions Committee ("RDC") of the Financial Services Authority ("the Authority") issued a decision notice addressed to the applicant, then and now known as 7722656 Canada Inc, but which previously, and at all times material to this decision, had carried on business in the name Swift Trade Inc, and to which we shall refer as "Swift Trade". The notice conveyed the RDC's decision, made on behalf of the Authority, that Swift Trade had committed market abuse in breach of s 118 of the Financial Services and Markets Act 2000 ("FSMA"), and that it had decided to impose a penalty for that conduct of £8 million.

2. The decision notice was referred to the tribunal on 1 June 2011, by both Swift Trade and by the Third Party, Peter Beck ("Mr Beck"), who (we were told) is a well-known Canadian entrepreneur and who was the President and Chief Executive Officer of Swift Trade, and the majority shareholder of BRMS Holdings Inc, a holding company of which Swift Trade was a wholly-owned subsidiary. His case is that he is affected by the decision notice and may be prejudiced, reputationally or otherwise, by it. His participation as a third party is not opposed by the Authority. However, as we heard no evidence from Mr Beck, and as his interests do not seem to differ in any material way from those of Swift Trade, we shall hereafter refer only to the conduct of Swift Trade, save to the fairly limited extent to which Mr Beck features personally in the events we describe.

3. Section 118, so far as relevant to these references, reads

> "(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which—
>
> (a) occurs in relation to—
>
> (i) qualifying investments admitted to trading on a prescribed market,…
>
> and
>
> (b) falls within any one or more of the types of behaviour set out in subsections (2) to (8) ….
>
> (5) The fourth [type of behaviour] is where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which—
>
> (a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or
>
> (b) secure the price of one or more such investments at an abnormal or artificial level ….
>
> (8) The seventh [type of behaviour] is where the behaviour (not falling within subsection (5), (6) or (7))—

(a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying investments, or

(b) would be, or would be likely to be, regarded by a regular user of the market as behaviour that would distort, or would be likely to distort, the market in such an investment,

and the behaviour is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market."

4. The Authority relies primarily on sub-s (5); but it contends that the conduct complained of is capable also of coming within sub-s (8). We shall consider the application of those subsections to the facts as we find them in due course. At this stage we should record the argument advanced by Swift Trade that, since it relied at all earlier stages in the process on sub-s (5), it is not permissible for the Authority now to rely in addition on sub-s (8); and even if it is it would be unfair to allow it to do so. We shall deal with this point too, so far as it is material, later in this decision.

Summary of the Authority's case

5. The essence of the Authority's case is that between 1 January 2007 and 4 January 2008 ("the relevant period") Swift Trade systematically and deliberately engaged in a form of manipulative trading activity known as "layering", in relation to shares traded on the London Stock Exchange (the "LSE"). It is undisputed that, by virtue of the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 ("the 2001 Order") the LSE is a prescribed market within the scope of s 118. It is not accepted by Swift Trade that it was dealing in qualifying investments within the meaning of the 2001 Order.

6. The Authority's case is that "layering" consists of the practice of entering relatively large orders on one side of an exchange's (in this case the LSE's) electronic order book ("the order book") without a genuine intention that the orders will be executed: the orders are placed at prices which are (so the person placing them believes) unlikely to attract counterparties, while they nevertheless achieve his objective of moving the price of the relevant share as the market adjusts to the fact that there has been an apparent shift in the balance of supply and demand. The movement is then followed by the execution of a trade on the opposite side of the order book which takes advantage of, and profits from, that movement. This trade is in turn followed by a rapid deletion of the large orders which had been entered for the purpose of causing the movement in price, and by repetition of the behaviour in reverse on the other side of the order book. In other words, a person engaged in layering attempts to move the price up in order to benefit from a sale at a high price, then attempts to move it down in order to buy again, but at a lower price, and typically repeats the process several times. Swift Trade does not disagree with that description of layering, though it argues that it is not a fair representation of the trading we must consider.

7. It is also undisputed that traders located in various countries around the world, and to whom we shall refer as "Dealers", placed orders for contracts for differences, or CFDs (sometimes known as "swaps"), using Swift Trade's facilities (to the character of which we shall come), with the UK subsidiaries of two large American financial institutions, Merrill Lynch International ("Merrill Lynch") and Penson Financial Services Ltd ("Penson"). They acted as Swift Trade's direct market access, or DMA, providers: Merrill Lynch until September 2007, when Swift Trade moved to Penson for reasons we shall explain later. The CFDs were placed in relation to shares quoted on the LSE. As the Dealers placed their CFD orders, Merrill Lynch and Penson hedged them by placing orders of their own, to buy or sell (depending on the nature of the CFD) an equivalent quantity of the shares. The hedging orders were placed automatically, by computer. As Merrill Lynch and Penson provided direct market access, the Dealers were able to see the LSE order book in "real time" and were thus also able to track the movements in price of the shares for which Merrill Lynch and Penson were placing orders. Almost all of the Dealers' orders were cancelled (if not previously executed) within a very short time, usually measured in seconds, of their being placed; and the hedging orders, which were cancelled as the CFDs were cancelled, likewise survived for very short periods.

Summary of Swift Trade's case

8. Swift Trade contends that the Authority's case is ill-conceived for a number of reasons. Those reasons can be encapsulated in a number of issues which, in the order with which we shall deal with them, are:

(1) That the decision notice is ineffective because the Authority does not have any jurisdiction over it.

(2) That the Dealers' activities did not fall within s 118, because the relevant trades (that is, the CFDs) were not in shares but in synthetic products, in other words derivatives rather than securities, albeit the underlying securities were shares listed on the LSE.

(3) Alternatively, that the trades on the LSE were undertaken, not by Swift Trade or the individual traders, but by Merrill Lynch or Penson, both of which are UK-regulated organisations.

(4) That, even if Swift Trade fails on issue (2), the activity about which the Authority complains was not manipulative, but legitimate high-volume day trading, by which traders bet on intra-day price changes in the equity markets, with a view to profiting from the changes. The Dealers had no interest in acquiring shares or investing in listed companies and, with very limited and incidental exceptions, all their positions were closed at the end of the trading day. The exceptions occurred only when the market closed before a position could be fully unwound (we should add that nothing of significance turns on those exceptions).

(5) That the trades were transparent to the market, did not lead to the making of a loss by any investor, and were in accordance with market

practice. Accordingly they were not abusive within the meaning of s 118, or indeed at all.

(6) That it was not Swift Trade itself which was initiating the trades but the Dealers, who were independent of Swift Trade and merely used the secondary DMA platform which Swift Trade provided. Since it had no control over their activities, it should have been treated in the same way as Merrill Lynch and Penson, that is there should have been no finding against it of market abuse, and correspondingly no penalty should have been imposed on it.

(7) That, even if the preceding contentions are wrong, Swift Trade had no reason to think that what was being done was improper, and is entitled to the benefit of the defence for which s 123(2) of FSMA (see para 42 below) provides;

(8) That Swift Trade's conduct was investigated in Canada by the Ontario Securities Commission ("OSC"), the result of which was a negotiated settlement which must be respected by the Authority and the tribunal. The Authority's actions were inappropriate in the light of that settlement, and the decision notice should be set aside.

9. After dealing with issue (1) we shall address issues (2) and (3) together, since they are in practical terms opposite sides of the same coin. We will then touch on the identification of the requisite burden and standard of proof, matters raised by Swift Trade although, in the event, they led to little controversy. For that reason we have not identified them as discrete issues in the list above, but we need to say something about them before coming to the disputed issues of fact, that is (4) to (7) above, which can also conveniently be considered together, and our conclusions on those matters. At that stage we shall address also the question whether the Authority may rely on s 118(8) as well as, or instead of, s 118(5). We shall conclude with issue (8).

10. We should add for completeness that there was some evidence, to which the Authority drew our attention, that Swift Trade had engaged in similar forms of trading on other markets, some within the European Union and some on, particularly, North American markets, but no reliance was placed by such trading in this reference and we need not say any more about it, save to the extent that it is relevant to the argument Swift Trade raised in relation to the Ontario action, to which we come later.

11. Swift Trade and Mr Beck were represented before us by Dr Michael von Pommern-Peglow of counsel, and the Authority by Mr Timothy Otty QC, leading Mr Simon Pritchard.

Issue (1): jurisdiction

12. Swift Trade was incorporated in accordance with the laws of Canada and, as Dr von Pommern-Peglow emphasised and the Authority accepted, had no place of business in the United Kingdom and was not regulated here; rather, it was regulated in Canada by the OSC. In addition, by the time the decision notice was issued, it had been dissolved and, in accordance with Canadian law (by which its

status must be judged, since it was a Canadian corporation) it had ceased to exist. Its case is the simple one that if it did not exist when the decision notice was issued, the notice must correspondingly be a nullity. It adds that it is likewise impossible to impose a penalty on a non-existent body.

13. It is common ground that Swift Trade's dissolution, on 13 December 2010, was the last of several steps undertaken in the first two weeks of that month. On 2 December Swift Trade was amalgamated with another of its holding company's wholly-owned subsidiaries. In the process it changed its name to 7722656 Canada Inc, though nothing more turns on that change of name. On 12 December it transferred all its assets to the holding company, BRMS Holdings Inc ("BRMS"), which in turn undertook to assume Swift Trade's liabilities, up to the value of those assets. On the following day Swift Trade entered into what we understand to be the Canadian equivalent of members' voluntary liquidation.

14. It is necessary to put those events in their chronological context. A preliminary investigation report, dated 30 October 2009, was produced by the Authority's investigation team. Swift Trade responded to it in detail, through its English solicitors, on 9 February 2010. The response led to an investigation report—essentially a development of the preliminary report, taking account of the representations—in July 2010. The warning notice was issued on 27 October 2010 (and therefore while Swift Trade still existed). In February 2011, by which time Swift Trade had been dissolved, BRMS's English solicitors made written submissions to the RDC, which met on 30 March 2011 to consider those submissions; neither BRMS nor Swift Trade was represented at that meeting. The decision notice was issued, as we have recorded, on 6 May 2011.

15. The Authority's retort to Swift Trade's argument is that, if it does not exist, it is difficult to see how it can refer a decision to this tribunal and appear, even if by counsel, before it; but, more substantively, that Canadian law does not have the effect for which Swift Trade contends. Section 226(2)(a) of the Canada Business Corporations Act 1985, which it is accepted is in point, provides that:

> "Notwithstanding the dissolution of a body corporate under this Act, a civil, criminal or administrative action or proceeding commenced by or against a body corporate before its dissolution may be continued as if the body corporate had not been dissolved."

16. The correct interpretation and application of that provision was the subject of the evidence of Mr Mark Connelly, a Canadian lawyer put forward by the Authority as an expert witness on Canadian law, and whom we accept in that capacity. He told us that s 226(2)(a) means exactly what it says, that proceedings such as those instituted by the Authority are regarded in Canada as an "administrative action" and that there is no distinction to be drawn for these purposes between proceedings in and proceedings out of Canada. Even if the better view is that it was the decision notice, rather than the warning notice, which marked the commencement of the proceedings, the position is the same, because of s 226(2)(b), which provides that

> "a civil, criminal or administrative action or proceeding may be brought against the body corporate within two years after its dissolution as if the body corporate had not been dissolved."

17. The Authority's principal argument is that the proceedings against Swift Trade were commenced, before its dissolution, by the issue of the warning notice, and the present reference to the tribunal represents a continuation of the same process, and s 226(2)(a) is engaged. But, alternatively, as the decision notice was issued well within the two-year period after dissolution, it followed from s 226(2)(b) that even if the better view was that the warning notice did not constitute the commencement of the proceedings, Canadian law would recognise the validity of proceedings commenced by issue of the decision notice.

18. Although Dr von Pommern-Peglow tested Mr Connelly's evidence in cross-examination, he was somewhat hampered in his challenge by his not having any expert evidence, or indeed any ammunition at all, of his own at his disposal. He referred us to the observation in *Dicey, Morris & Collins, The Conflict of Laws*, 14th edition at rule 161 that "Whether an entity exists as a matter of law must, in principle, depend upon the law of the country under which it was formed", and to *Gore-Brown on Companies* in which, in the current edition at para 63[14], it is said that "… a dissolution …, which is effective under the law of the country of incorporation, is recognised in England". Dr von Pommern-Peglow also referred us to a number of authorities which support that statement. As propositions of law, however, they seem to us to be uncontroversial and in no way inconsistent with what Mr Connelly said. More important was Dr von Pommern-Peglow's reliance on the comment in *Gore Brown* at para 60[9] that "A company which has been dissolved in its jurisdiction of incorporation must be treated as dissolved everywhere and as having no existence". Again, as a plain statement of first principle, we see nothing controversial in it.

19. Where Dr von Pommern-Peglow and the Authority parted company was in respect of his argument that, to borrow again from *Dicey, Morris & Collins* at rule 17, "All matters of procedure are governed by the domestic law of the country to which the court wherein any legal proceedings are taken belongs." That rule led, he said, to the conclusion that if, as is the case in England and Wales, a dissolved company has no existence, it does not help the Authority to rely on a Canadian provision which, as s 226 does, provides for the survival of certain Canadian procedures. Section 226 does not apply in England, and cannot have the same effect here as it has in Canada; and in the absence of any corresponding provision of English law (and there is none) this tribunal, like the courts, cannot exercise jurisdiction over a non-existent entity. For that proposition he relied on *Banque Internationale de Commerce de Petrograd v Goukassow* [1923] 2 KB 682. We do not, however, think that case offers any support to his argument. A bank with the name of the purported plaintiff had been incorporated in pre-revolutionary Russia. Following the revolution, all private banks (of which it was one) were "extinguished" by decree, and ceased to exist. The new Soviet government and decrees it had passed were recognised in the United Kingdom, but not in France, which consequently did not give effect to the decree and treated the Paris branch of the bank as having a continuing existence. The defendant was indebted to that branch, which attempted to sue him in England. The action was struck out on the ground that as English law recognised the relevant decree, it also had to treat the bank as non-existent. The difference between that case and this is that there was no identifiable provision of Soviet law which corresponded with s 226, and therefore no provision which preserved the bank even for limited purposes.

20. Dr von Pommern-Peglow also referred us to ss 1029 to 1032 of the Companies Act 2006, which provide for the restoration to the register of a company which has been dissolved. On restoration the position, as nearly as may be, is that the company is treated as if it had never been dissolved; but those provisions do not alter the fact that a company which has been dissolved but not restored has ceased to exist for all purposes. That proposition, too, is uncontroversial, but it seems to us quite irrelevant as the Act has no application to Canadian corporations.

21. We found Mr Connelly's evidence on Canadian law persuasive, and are satisfied that it does provide that Swift Trade has a continuing, even if limited, existence sufficient to validate proceedings against it in Canada. That is not the same as saying that it remains in existence for the purposes of English law, as Dr von Pommern-Peglow rightly said, but Mr Connelly's evidence was not that s 226 is confined to Canadian proceedings, but that it is of more general application, validating (within the confines of the section) proceedings against the company, irrespective of the forum. In other words, it is not a purely Canadian procedural provision, but a provision which (for reasons we shall develop shortly) preserves the otherwise dissolved company for certain purposes. We observe too that, although it plainly does have some procedural characteristics, we detect nothing in the section consistent with an intention that its effects are to be confined exclusively to Canadian proceedings.

22. Mr Otty referred us to a judgment in which a similar point arose in a slightly different context, namely that of Moore-Bick J in *Phoenix Marine Inc v China Ocean Shipping and Another* [1999] 1 Lloyds L R 682. The judge was required to consider the position of a Panamanian plaintiff company which had entered into an arrangement similar to members' voluntary liquidation after proceedings had been commenced, in England, against a defendant which, alerted to the plaintiff's subsequent dissolution, secured an order for the trial of a preliminary issue, namely whether the plaintiff still existed. A provision of Panamanian law allowed for the bringing of an action by a dissolved company within three years of its dissolution, but was silent about the position if such proceedings were commenced in time, but had not been concluded before the three-year period expired. At p 687 the judge said:

> "… I think it likely that the Court would hold that the company remains in existence until proceedings initiated within the three-year period following dissolution have been brought to a conclusion since to hold otherwise would be to deprive [the relevant provision] of much of its effect … Accordingly I find that the plaintiff does still exist, albeit in a shadowy form and for limited purposes which include the conduct of any proceedings still pending."

23. Thus the English proceedings were competent notwithstanding the dissolution of the plaintiff and the expiry of the three-year period. We are not unmindful of Dr von Pommern-Peglow's point that a distinction must be drawn between procedural and substantive provisions; but as we have indicated we do not view s 226 as purely procedural. As in *Phoenix Marine v China Ocean Shipping*, the construction of the provision as one enabling proceedings to continue, but nothing more, would deprive it of much of its effect.

24. The logical consequence of Dr von Pommern-Peglow's argument, as we see it, is that proceedings may be taken or continued against a dissolved company but the company cannot participate (since s 226(2) makes no express provision for it to do so) and that the outcome of the proceedings, even if they are Canadian, and whatever it might be, is of no more than academic interest since the company cannot be affected by it. That, if we may say so, is a nonsense. It is in our view plain that, alien though the concept may be to English law, the Canadian law which determines Swift Trade's existence provides that it continues to exist, notwithstanding its dissolution, for limited purposes which include proceedings of the kind with which we are concerned.

25. The conclusion we have reached on this issue, on either view—that is, the proceedings were initiated on the one hand by the warning notice and on the other by the decision notice—is that the period prescribed by respectively s 226(2)(a) or (b) was (and is) still current and that the proceedings are effective.

Issues (2) and (3): derivatives trading and the position of DMA providers

26. As we have explained, it is common ground that the orders placed by Swift Trade with Merrill Lynch and Penson were not for shares, but for derivatives, in the form of CFDs, that Merrill Lynch and Penson immediately placed exactly corresponding orders on the LSE order book for the purpose of hedging their positions, and that those orders were placed by computer, without human intervention. Similarly as Swift Trade cancelled or amended its orders, the Merrill Lynch or Penson computers immediately effected matching cancellations or amendments of the orders they had placed.

27. The advantage to a dealer of trading in CFDs or similar derivatives is that he is able to take advantage of movements in the price of a security without the need to purchase the security. He thus utilises relatively little cash, and does not incur acquisition costs, particularly stamp duty. Merrill Lynch and Penson did levy transaction charges for the use of Swift Trade's DMA facilities, but they were very modest, and considerably less than the costs Swift Trade or the Dealers would have incurred had they dealt in securities. All of the witnesses from whom we heard (we come to the detail of their evidence below) who expressed a view on this point said that in their experience Swift Trade's arrangements with Merrill Lynch and Penson, and in particular the automatic hedging of the orders as they were placed, amended and cancelled, was standard practice among institutions offering CFDs.

28. Swift Trade's case is that (assuming the remainder of the Authority's arguments are made out) it was not dealing in, as s 118 requires, "qualifying investments admitted to trading on a prescribed market"; it entered into agreements with its DMA providers which referred only to the synthetic products in which it did deal, and which did not answer to that description. They were effectively bets on price movements, and not investments at all. Although Swift Trade knew that they were doing so, the fact remained that if Merrill Lynch and Penson chose to hedge the Dealers' bets by placing orders for shares they did so on their own account and the resultant price movements, if any, were caused by their choosing to hedge, and not by any action on Swift Trade's part. A construction of s 118 which brought such bets within its scope would be not only

in breach of fundamental principles of statutory construction but also contrary to the Directive of the European Parliament and of the Council 2003/6/EC ("the Market Abuse Directive").

29. The contractual relationships between Swift Trade and Merrill Lynch and Penson were governed by industry standard contracts, known as ISDA Master Agreements. They provide (as the Authority accepts) only for the parties to enter into binding obligations to purchase and sell CFDs and other synthetic products, and not shares. Whether or not the CFD positions created are then hedged is not addressed in the ISDA Agreements and is irrelevant for the operation and validity of such agreements. The use by Swift Trade of Merrill Lynch's DMA platform was governed by an agreement for synthetic DMA trading. That agreement, too, did not refer to Merrill Lynch's hedging of the bets. It did, however, give Merrill Lynch a wide discretion to disallow orders, or to cancel them, and thus conferred a considerable measure of control on it. The later agreement with Penson was identical for all practical purposes. There was no provision in either agreement importing the LSE rules or guidance published by the Authority. Dr von Pommern-Peglow emphasised (although there was no evidence before us to support the assertion and such evidence as we had was rather to the contrary) that Swift Trade had explained fully to Merrill Lynch and Penson both the nature of its activities and its strategy, and that they had entered into the agreements knowing of that strategy. As we explain below, we reject these contentions, but for the purpose of dealing with this issue we assume them to be correct.

30. The "qualifying investments", to which s 118 relates are defined by art 5(1) of the 2001 Order as

> "… all financial instruments within the meaning given in Article 1(3) of [the Market Abuse Directive] …".

31. That article, as amended and in force at the relevant time, reads:

> "'Financial instrument' shall mean:
>
> — transferable securities as defined in Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field,
>
> — units in collective investment undertakings,
>
> — money-market instruments,
>
> — financial-futures contracts, including equivalent cash-settled instruments,
>
> — forward interest-rate agreements,
>
> — interest-rate, currency and equity swaps,
>
> — options to acquire or dispose of any instrument falling into these categories, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates,
>
> — derivatives on commodities,

— any other instrument admitted to trading on a regulated market in a Member State or for which a request for admission to trading on such a market has been made.”

32. Those categories do not include CFDs nor, said Dr von Pommern-Peglow, is the expression “equity swaps” apt to include an arrangement of this kind, in which short-term dealing, designed to take advantage of intra-day price movements, is hedged by the counter-party. This conclusion is supported, he added, by comparison of s 118 with s 118A(3)(a), which relates to conduct falling within s 118(4) or (8) but, conspicuously, not s 118(5). It provides that

> “… behaviour that is to be regarded as occurring in relation to qualifying investments includes behaviour which—
>
> (a) occurs in relation to anything that is the subject matter, or whose price or value is, expressed by reference to the price or value of the qualifying investments ….”

33. The inclusion of that provision in s 118A(3)(a) is a clear indication, Dr von Pommern-Peglow argued, that the draftsman intended that while some types of the behaviour at which s 118 is aimed are to be culpable when undertaken in relation to derivatives, that is not the case in respect of behaviour within sub-s (5). It would have been simple to extend s 118A(3)(a) to include behaviour within sub-s (5) had that been the intention; the inference must therefore be that a deliberate decision had been taken to exclude it.

34. The Authority’s response is that Dr von Pommern-Peglow’s arguments disregard the wording of s 118, which refers to “behaviour which occurs … *in relation to*” qualifying investments and includes “effecting transactions or orders to trade”; it is not necessary that there be trading *directly* in a qualifying investment admitted to trading on a market such as the LSE. Moreover, they ignore the commercial reality of what Swift Trade’s conduct involved; it knew, and as the evidence with which we deal below showed intended, that Merrill Lynch and Penson would hedge the Dealers’ orders and its whole strategy was based upon that automatic hedging.

35. That interpretation of s 118, the Authority adds, is also the only one which is consistent with market understanding and commercial sense, and the obvious purpose of the statutory provision. It is readily apparent from its wording that it is designed to prevent behaviour which distorts the market by giving a false or misleading impression of supply or demand for a particular share. Swift Trade’s approach would leave a significant gap in market protection, and it ignored long-standing market guidance published by the Authority. The tribunal should take into account the views of users of the market in this regard and give the term the meaning they attach to it: see *Bennion on Statutory Interpretation* 5th ed at sections 365 and 367.

36. It is conspicuous, in relation to that argument, that all of the witnesses who gave evidence to us were of the view that Swift Trade’s conduct, as it was identified by the Authority, was in relation to qualifying investments. Indeed, the point was most succinctly put by an expert, Dr Desmond Fitzgerald, whose report Swift Trade had disclosed at an earlier stage although it did not rely on his evidence before us. At para 1.4 of his report he said:

"Swift Trade's position that it was never trading on the LSE is unsustainable and no reasonable equity market participant would come to any other conclusion."

37. It will become apparent from our conclusions on the nature of Swift Trade's activities that we are satisfied that the Authority has made out its case that the orders were placed in the knowledge and expectation that Merrill Lynch and Penson would immediately and automatically match them with hedging orders, and with the intention that they should do so. Even though, if one looks at the matter pedantically, Merrill Lynch and Penson placed the orders on the LSE, it is quite clear that they did so only in response to orders for CFDs received by them from Swift Trade. The reality is that it was Swift Trade which caused the orders to be placed. We agree with Mr Otty that Swift Trade's position is contrary to common sense and does not reflect market understanding or market practice.

38. Moreover, the fallacy of Dr von Pommern-Peglow's argument that dealing in CFDs is not within the scope of s 118(5) is, we think, easily exposed. Examination of the opening words of s 118(1) of FSMA: "For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) …" shows that it is not necessarily the conduct of one person alone which is relevant. Two or more persons acting in concert would ordinarily have a common purpose and understanding, but there is nothing in the section which requires that persons acting jointly should have either a common purpose or a common understanding. The use of the conjunction "or" between "jointly" and "in concert" suggests that the draftsman was not using two synonyms, but terms meaning different things: persons acting together who may not have a common purpose or intention, and persons acting together with such a purpose or intention. Thus in our view it is not possible to avoid liability for conduct which otherwise falls within s 118(5) by arguing that an unwitting intermediary came between the supposed abuser and the market.

39. That proposition can be simply illustrated. Anyone dealing on an exchange who is not a member of that exchange necessarily has to deal through an intermediary, whether a broker or, as here, a member which offers direct market access. If Swift Trade, with no DMA facility, had placed orders for shares, rather than for CFDs, with a broker who was a member of the LSE it is obvious it could not argue that its orders were not caught by s 118(5) (assuming they were otherwise abusive) because they were placed by an unwitting broker. We cannot see any material difference in the outcome when the placing of an order for a CFD, as the person placing that order knows and intends, results in the placing of a corresponding order for the underlying shares. Such conduct is, in our view indisputably, "behaviour … which … occurs in relation to … qualifying investments…".

40. We therefore conclude that derivatives trading may fall within the scope of s 118(5), and accordingly determine issue (2) in the Authority's favour.

41. For the same reasons it seems to us that Swift Trade's argument that it was Merrill Lynch or, later, Penson which placed the orders is unsustainable. As we have said, pedantically speaking they did do so, but only by way of an automated reaction to Swift Trade's orders. The reality is that it was Swift Trade, or the

Dealers, which caused the orders to be placed, while Merrill Lynch and Penson performed a purely mechanical function. We cannot accept that what Merrill Lynch and Penson did brings them within the intended scope of s 118; but even if it does, the absence of any action against them by the LSE or the Authority is immaterial to the question whether Swift Trade's conduct offends s 118.

The burden and standard of proof

42. On this issue Dr von Pommern-Peglow's contention was that, as the reference related to the imposition of a penalty, article 6 of the Human Rights Convention is engaged, a proposition from which the Authority does not demur. It follows that the burden of proof lies on the Authority. That too is accepted, at least in respect of the establishment of the factual basis of the Authority's case, and is in any event long-established. The parties differed, however, on two matters. First, Dr von Pommern-Peglow argued that the Authority bears the burden of showing that s 123(2), which is commonly known as the "statutory defence", is not satisfied. It is convenient at this point to set out the whole of s 123:

> "(1) If the Authority is satisfied that a person ("A")—
>
> (a) is or has engaged in market abuse, or
>
> (b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse,
>
> it may impose on him a penalty of such amount as it considers appropriate.
>
> (2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that—
>
> (a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or
>
> (b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.
>
> (3) If the Authority is entitled to impose a penalty on a person under this section it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse."

43. It is apparent from the extract from s 118 that we have set out above that the intentions of the person concerned are not a material factor; indeed, it is possible to commit market abuse inadvertently, although the circumstances in which behaviour falling within sub-s (5) might be inadvertent are, one may think, somewhat limited. As we see it, s 123(2) provides a safeguard by allowing for an escape, in appropriate cases, from the seemingly absolute terms of s 118. Whether the defence is made out in this case as a matter of fact is an issue (number (7) in the list set out above) to which we shall return.

44. Dr von Pommern-Peglow's argument, in essence, was that once it is accepted that the burden of proof rests on the Authority, it follows that it bears that burden in respect of every element of the case. He did not produce any

authority which supports that proposition, and the difficulty we see in the argument is that it is not consistent with the words used in the subsection. It provides that no penalty may be imposed "if there are reasonable grounds for [the Authority] to be satisfied" that the defence is made out. It does not provide that a penalty may be imposed only if the Authority is satisfied that the defence is *not* made out. Moreover, the Authority has to be satisfied of matters which are, or should be, within the knowledge of the person concerned. It is, plainly, the purpose of the inclusion within s 123(2) of the phrase "having considered any representations made to it in response to a warning notice" to make it clear that the person concerned must have opportunity of putting forward a defence, including facts and matters known to him but not the Authority, before the question of the Authority's satisfaction is determined. In our view it follows that the burden of establishing the defence must rest, in accordance with ordinary principles, on the person who advances it. That, as we see it, is the plain purpose of the provision.

45. We do not see anything in article 6 of the Convention which undermines that conclusion. While the presumption of innocence is enshrined in paragraph 2, it implies no more than that the primary burden of proof lies on the prosecution. It does not, for example, preclude the drawing of adverse inferences from a failure on the part of the person accused to give evidence (see *Murray v United Kingdom* (1994) 22 EHRR 29), and it does not relieve an accused person of the burden of establishing a defence: see *Lingens and Leitgens v Austria* (1983) 26 DR 171. Thus we conclude that the burden of showing that the s 123(2) defence is made out in this reference rests upon Swift Trade.

46. The second matter on which the parties differed arose from Dr von Pommern-Peglow's argument that, although references to this tribunal are classed as civil proceedings in domestic law, the standard of proof is what is described in Swift Trade's reply as "a heightened civil standard of proof which is virtually indistinguishable from the criminal standard of proof". The Authority contends that the relevant standard is the balance of probabilities.

47. It is right to record that Dr von Pommern-Peglow accepted, after very little debate, that his argument on this point could not succeed. However, since the matter was raised we should deal with it. The same argument was examined in some detail by the Financial Services and Markets Tribunal in *Davidson and Tatham v the Authority* (1986, Decision 031) at paras 187 to 197, where it concluded that there is nothing in article 6 which demands proof to any particular standard. We respectfully agree. In *Re H* [1996] AC 563 at 586, Lord Nicholls of Birkenhead said that

> "Where the matters in issue are facts the standard of proof required in non-criminal proceedings is the preponderance of probability, usually referred to as the balance of probability. This is the established general principle … The balance of probability standard means that a court is satisfied an event occurred if the court considers that, on the evidence, the occurrence of the event was more likely than not. When assessing the probabilities the court will have in mind as a factor, to whatever extent is appropriate in the particular case, that the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the

court concludes that the allegation is established on the balance of probability. Fraud is usually less likely than negligence … Built into the preponderance of probability standard is a generous degree of flexibility in respect of the seriousness of the allegation.

> Although the result is much the same, this does not mean that where a serious allegation is in issue the standard of proof required is higher. It means only that the inherent probability or improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established."

48. Although those observations are, in our view, admirably clear, they nevertheless led in some quarters to the view that there was a third standard, lying somewhere between the ordinary civil and the criminal standards, and varying in a somewhat undefined way broadly in line with the gravity of an allegation, until the matter was put beyond argument by Lord Hoffman in *Re B (Children)* [2008] UKHL 35 at [13]:

> "the time has come to say, once and for all, that there is only one civil standard of proof and that is proof that the fact in issue more probably occurred than not."

49. We approach the reference, therefore, upon the basis that because the allegations are serious the evidence the Authority must adduce to establish them must be cogent and clear; but it is not required to do any more than satisfy us that the market abuse alleged more probably occurred than not. We add, in deference to a point made by Dr von Pommern-Peglow though it is uncontroversial (and in any event plain from s 133 of FSMA), that we are required, not to determine whether the RDC came to a reasonable decision, but to consider the evidence afresh and reach our own conclusions.

Issues (4), (5), (6) and (7): the factual disputes

50. The Authority does not argue that all of Swift Trade's trading activity during the relevant period was abusive, but it does contend that it engaged in a widespread, deliberate and systematic abusive trading pattern. That trading was, it says, directed and controlled by Swift Trade, and was knowing and deliberate market abuse. It was designed to profit from the relatively small price movements the trade caused, enabling Swift Trade to buy cheaply after triggering a fall in the share price, and to sell at a high price after triggering a rise. Alternatively, it was able to sell short advantageously after causing a rise, whereupon it placed orders designed to push the price down in order to buy cheaply. Although the individual price movements were generally small, and the profit from each individual trade also small (and, when orders occasionally executed unexpectedly and contrary to the underlying intention, there were some losses) over time the accumulated profits resulting from the trading were substantial.

51. The evidence available to us did not extend to the detail of the arrangements between Swift Trade and the Dealers, and it may well be that its arrangements with individual Dealers differed, but it was clear (and not disputed) that Swift Trade took a share of the Dealers' profits. The Authority estimates that Swift

Trade itself made a net profit of more than £1.75m during the relevant period; it concedes that it cannot show from the available evidence how much of that profit was due to abusive trades, but contends that it is a fair inference that the greater part of it is attributable to such trade. We did not hear any argument by Swift Trade that, if the remainder of the Authority's case was made out, we should examine the extent of its abusive profit ourselves, and consequently we shall not do so, but will instead assume that the Authority's figure does not overstate it.

52. For reasons on which we expand at para 60 below, Swift Trade does not deny that trading of the kind alleged by the Authority took place, though it does not concede that it was either systematic or controlled. In essence, it contends that the Dealers were attempting to profit in a market dominated by others using computers applying algorithms (what Dr von Pommern-Peglow termed "algo trading"), a system which depends on minimal human input. Because the algorithms were designed to react in pre-determined ways to price movements, it was possible, Dr von Pommern-Peglow said, for human traders to do better by taking advantage of those predictable reactions. Among the documentation to which we shall come later were several comments about the perceived stupidity of algo trading.

53. Swift Trade argues that trading of the kind in which the Dealers engaged was not abusive since it was undertaken in accordance with established market practice, that is by the Dealers reacting to market movements but in a more intelligent manner than was possible by algo trading; and that what was being done would have been apparent to other market users, albeit they might have found their reliance on algorithms to the exclusion of human analysis put them at a disadvantage. The trading pattern was not concealed, it says, and could therefore not have been likely to give a misleading impression. The evidence with which we deal in this section relates also to Swift Trade's subsidiary arguments that the trading was in any event not undertaken by itself but by the Dealers acting independently, that no losses were caused, and that Swift Trade is protected by the statutory defence.

54. We had the written and oral evidence of eight witnesses of fact, all called by the Authority:

- Mr Alexander Shvorob, a partner and portfolio manager at GSA Capital Partners LLP, an investment management company;
- Dr Christopher Townsend, managing director of the equities trading division of UBS AG;
- Miss Jeannette Cowan, at the relevant time head of market supervision at the LSE;
- Mr David Hacon, employed by the Authority as a technical specialist in its Enforcement and Financial Crime Division;
- Mr Giles Harry, an accountant and investigator also employed by the Authority in that Division;
- Mr Andrew Pickering, at the relevant time a director and chief financial officer of Penson;

- Mr Anthony Walker, director of execution services at Merrill Lynch; and
- Mr Ashok Krishnan, managing director and head of the equity execution services team of Merrill Lynch.

5 55. We had in addition the unchallenged witness statement of Mr Michael Straughan, who is employed by the Authority as a manager in its Economics of Financial Regulation Department, who undertook some statistical analysis to which we shall come later in this decision.

56. Both parties adduced some expert evidence relating to the nature of the
10 trading and the conclusions to be drawn from it. For the Authority, we heard from

- Mr Keith Martin, an experienced trader in equities with long experience at UK board level in well-known trading houses; and
- Professor Oliver Linton, formerly Professor of Econometrics at the London School of Economics and now Professor of Political
15 Economy at Cambridge University.

57. Swift Trade's expert evidence was provided by

- Professor Philip Bond, who is a Visiting Fellow of the Oxford Centre for Industrial and Applied Mathematics and Visiting Professor to the Departments of Engineering Mathematics and Computer Science at
20 Bristol University, with a special interest in computer-based trading in financial markets; he also has experience as a trader and hedge fund manager.

58. We accept that all of the experts had appropriate expertise and were competent to give the evidence they offered.

25 *Swift Trade's trading pattern*

59. It was not apparent to us at the beginning of the hearing whether any issue was taken about the pattern of trading asserted by the Authority (leaving aside the inferences to be drawn from it). Its analysis of the trading was based upon sampling exercises undertaken by its staff, particularly Mr Straughan and Mr
30 Hacon, which were intended to determine whether or not there was evidence of layering. Sampling was necessary because of the very large number, around 60,000, of dealing records (each consisting of a number of orders together making up, if the Authority is correct, an individual episode of layering) which had occurred during the relevant period; that sheer volume made detailed analysis of
35 every record impractical. It was said that the total number of Swift Trade's individual orders on the LSE in the relevant period was in the order of 16 million.

60. There was some debate during the course of the hearing about the suitability of sampling, since the experts had not then produced a statement of those matters on which they agreed and those on which they differed, but it later became clear
40 that Professor Bond agreed with Professor Linton's view that the analysis of a relatively small number of sample records was sufficient to enable an analyst to draw reliable conclusions, albeit they disagreed about what those conclusions should be. Those used for the purpose, it was accepted, had been chosen at

random. We shall return to the expert evidence when we have described the evidence of fact available to us.

61. However, it is convenient to mention at this stage that we were presented with several graphs prepared by the Authority's staff for the purpose of illustrating the LSE orders on which it does rely, and their characteristics. The accuracy of the graphical depictions was not challenged (and, conspicuously, Swift Trade adduced no evidence of its own about its trading), even if, again, the conclusions to be drawn from the graphs were not agreed. They show substantial numbers of individual, cumulatively large, orders, placed by Swift Trade or the Dealers on one side of the order book at levels which are at some distance from the "touch" (which is comprised of the highest bid price and lowest offer price quoted at a given point in time) although there was some evidence of smaller orders which, the Authority says, were placed for the purpose of testing the reaction before the volume of orders was increased. Most of these orders, as we have said, survived for extremely short periods before they were cancelled; those few which did not survive to cancellation were the orders which were executed, because the touch moved unexpectedly before cancellation could be effected. On the other side of the order book, and at the same time, Swift Trade or the Dealers placed smaller orders, fewer in number and usually closer to the touch, almost all of which did execute because the touch moved towards the price at which they had been placed.

62. It is fundamental to the Authority's case that the trading demonstrated by the analysis of the trades which was reproduced on the graphs is consistent only with the conclusion that Swift Trade's large orders were not intended to be executed, but only to move the touch price. Swift Trade's counter-argument is that there was no manipulative strategy, and that what is shown by the graphs is no more than the natural consequence of the legitimate trading in which the Dealers engaged.

63. The essential questions are twofold. First, was the trading pattern revealed by the graphs, as illuminated by the other evidence we heard, consistent with a deliberate trading strategy such as the Authority alleges? That is to say, has the Authority shown that Swift Trade engaged in the systematic placing of trades in high volumes on one side of the order book, at prices pitched at such levels as to be indicative of an intention that they should not execute but that the touch should nevertheless be influenced by their placement? Has it also shown that such orders were coupled with the placing of smaller orders on the other side, which were intended to, and frequently did, execute at prices advantageous to Swift Trade? And has it shown that orders of that kind were followed by a reversal of the strategy, and of repetition of the pattern? Second, if the Authority is able to show that there was a strategy of that kind, was it encouraged, if not orchestrated, by Swift Trade or, instead, pursued by independent Dealers over whose activities Swift Trade had little or no control? If the Authority's case on those two issues is made out, we need to determine whether Swift Trade's strategy was visible to the market and consistent with recognised market practice, or abusive; and if the latter, whether Swift Trade could reasonably have thought that it was legitimate.

64. Although, logically, the issues present themselves in that order the oral and documentary evidence, to which we come next, is relevant to all of them, and they

are in any event intertwined; accordingly we shall deal with them together. As we have said, the oral evidence of fact came entirely from the Authority's witnesses, but a good deal of documentary evidence, most importantly emails, generated by Swift Trade and the Dealers, was available. Dr von Pommern-Peglow attempted to cast doubt, or at least a different light, on what the oral witnesses said, but in our view he was wholly unsuccessful in that endeavour. Rather than repeat ourselves below, we record at the outset that we found all of the witnesses of fact credible, and we accept what they told us.

65. We interpose that a good deal of time was devoted in the hearing to certain dealing practices in which Swift Trade did not engage, in particular the placing of "iceberg" orders (permitted by LSE rules), that is orders for a moderate number of shares placed when the person bidding or offering in fact intends to buy or sell substantially more. The purpose of placing orders for, commonly, 10% of a large volume at a time is to reduce the impact on the price which placing the whole order would have. Dr von Pommern-Peglow and Professor Bond made a number of critical comments about "iceberg" orders, and Dr von Pommern-Peglow was himself somewhat scornful of algo trading. However, as he correctly recognised, the question before us is not whether other practices are appropriate, still less are we to undertake a wide-ranging review of the LSE rules. The only question we must answer is whether Swift Trade engaged in market abuse contrary to s 118(5) or, if not and we conclude it is open to us to do so, whether its conduct contravened s 118(8).

The characteristics and impact of the trades

66. The documentary evidence to which we shall come shortly shows that Merrill Lynch and, after Swift Trade had moved to Penson in September 2007, Penson too, expressed concern about its trading methods. Mr Shvorob and Dr Townsend, to the detail of whose evidence we come shortly, told us that they had also observed oddities about market movements which could be related to orders placed by Merrill Lynch and Penson in response to Swift Trade's activities, and these concerns came to the attention of the LSE, which made some enquiries of its own in consequence.

67. Miss Cowan's evidence was that in March 2007 her office was contacted by a member firm (as we were to learn, GSA Capital) which was concerned about what it believed to be manipulative trading. The contact led to investigation by the LSE of trading records, an investigation which in turn led to communications between the LSE, Merrill Lynch and, in due course, Swift Trade (the LSE could tell from its records which member firm was placing orders, but not the identity of its client which was initiating them), in which the nature of its trading was discussed, and the LSE's concerns identified. Swift Trade offered various explanations and assurances but at the end of May 2007 Merrill Lynch suspended its facilities, in the light of its own continuing concerns. However, on 4 June, once Swift Trade had implemented some restrictions dictated by Merrill Lynch, the facilities were restored. Miss Cowan told us that from then until early September 2007 the apparent level of suspected layering activity was significantly reduced, but it then resumed.

68. She told us that the LSE had been able to analyse the relevant trades, and reach these conclusions, by the use of what she described as a "layering tool" which, although it was introduced only in May 2008, had been applied to historical data. It detected 26,785 "hits", that is apparent layering, in the months from January to May 2007, of which Merrill Lynch accounted for 25,917 or 96.7%; 3,150 from June to August 2007, of which Merrill Lynch accounted for only 128; and 35,152 "hits" from October 2007 to January 2008, of which Penson (to which Swift Trade had by then moved) accounted for 31,834 or 90.5%. Further enquiry showed that Swift Trade was responsible for the great majority of the "hits" which related to trades placed through Merrill Lynch and Penson. Miss Cowan added that the levels of "hits" seen in the two periods, January to May and October to January, had not been seen previously, and that the only LSE member firms affected to such an extent were Merrill Lynch and Penson.

69. On 5 September 2007 Merrill Lynch informed the LSE that Swift Trade's facilities with it were to be withdrawn entirely on 7 September, and from on or about that date Swift Trade instead used the facilities it had secured with Penson. We shall deal later with the transfer of its business. It was not long, Miss Cowan said, before member firms were again complaining about suspected layering, and her office made further enquiries, this time through Penson. The enquiries led to a request by the LSE to Penson to withdraw Swift Trade's facilities, which was done on 4 January 2008, the last day of the relevant period. Swift Trade's facilities were later restored, but with controls (additional to those already put in place, which we shall outline below) decided upon and implemented by Penson.

70. On 3 December 2007 the LSE issued a notice designed to emphasise the fact that its rules prohibited conduct of this kind; it referred to Swift Trade's activities, though did not identify it or its DMA provider by name. At the same time the guidance published with the rules was amended, for the same reason.

71. The LSE's concerns about Swift Trade's conduct related specifically to its potentially misleading impact. Its conclusion from its enquiries was that orders were being placed, not with the intention of execution but, rather, to influence the perception of demand and supply; Miss Cowan provided examples of price movements which the LSE had identified as having been triggered by the conduct. Such conduct has, she said, been consistently prohibited by LSE Rules, particularly those entitled "Misleading acts, conduct and prohibited practices" (formerly rule 3300, now rule 1400) and "Share price manipulation" (formerly rule 3301, now rule 1410), which were in materially the same form throughout the relevant period. Rule 1400 provides that

> "A member firm shall not, in respect of its on Exchange business:
>
> 1400.1 do any act or engage in any course of conduct which creates or is likely to create a false or misleading impression as to the market in, or the price or value of, any security".

72. Rule 1410, as it now is, reads

> "A member firm trading in a security shall not do any act or engage in any course of conduct the sole or main intention of which is to move the price of that security …".

73. Guidance to rule 1400, headed "Entry and deletion of orders" reads

> "All orders entered onto the order book are firm. While the Exchange understands that trading decisions of member firms may change during the auction process, member firms should not enter orders into the auction or during continuous trading with the intention of deleting or otherwise amending them before the auction uncrossing, to give a potentially misleading impression of the likely auction uncrossing price and volume to other participants …"

74. We interpose that the Authority's interpretation of this guidance (which was also Miss Cowan's understanding) is that the placing of deliberately short-lived orders, that is orders placed at a distance from the touch and which survive for a very short period, in this case seconds, cannot realistically be considered to be intended to execute, and their placement is prohibited. Indeed, the additional controls implemented by Penson on restoration of Swift Trade's facilities following their suspension in January 2008, to which we have referred above, included a minimum resting time for orders. In our view, the meaning and intent of both the rule and the guidance are clear: the placing of short-lived orders not intended to execute but which (whether or not it is the trader's intention) may give a false impression of demand or volume is unacceptable. However, although compliance or lack of compliance with the rules of a particular market is an important consideration, we are not required to decide whether Swift Trade breached the LSE's rules, but whether its conduct offends s 118.

75. We have already mentioned the graphical representations of Swift Trade's, or the Dealers', orders, and their source in the analysis of the detailed records, provided by Merrill Lynch and Penson, carried out by Mr Hacon and others of the Authority's staff, particularly Mr Harry and Mr Straughan, whose evidence it is unnecessary to describe in view of Dr von Pommern-Peglow's acceptance of the accuracy of the graphs. We also do not need to deal with the graphs further, save to say that we agree with Mr Hacon's conclusion, which was firmly supported by both Mr Martin and Professor Linton, that they illustrate the unusual nature of Swift Trade's conduct, compared with that of other market users whose contemporaneous orders were also shown on them. The sizes of Swift Trade's orders, and the short periods for which they remained live before cancellation, were quite striking. We accept too Mr Hacon's evidence (which was supported by and consistent with that of Mr Shvorob and Dr Townsend, to which we come next) that, intentionally or not, Swift Trade's conduct succeeded in moving the prevailing touch price of relevant shares, and yielding profits over very short periods of time. We have set out much of what Mr Hacon told us, by way of background and in relation to the detail of the case, elsewhere in this decision, and we mean no disrespect to him in not always attributing either the evidence or those of our findings which are based on it to him.

76. Mr Shvorob was one of the market participants who observed the effects of Swift Trade's behaviour. He is an experienced market user, a partner at GSA Capital since its foundation in 2005, and an employee of other London institutions for the five previous years. His main expertise is in statistical arbitrage, that is, as he described it, "the identification of anomalies or inefficiencies between securities in the marketplace." That identification is carried out by computer

programs, and GSA Capital attempts to profit from the anomalies and inefficiencies by, to use Dr von Pommern-Peglow's term, high frequency algo trading.

77. In January 2007, he said, he observed unusual features in certain LSE trades, which he examined by adjusting the computer model he used in order to identify what was its cause. He said that it was not explicable by ordinary changes of investment intentions, but clearly indicated that orders were being put on the order book which were not intended or expected to execute.

78. His examination gave rise to concerns which led to the sending by GSA Capital to the Authority of a letter of 28 February 2007, in which the behaviour he had observed was described. After the action taken by the LSE of which we have given details above, Mr Shvorob said, the behaviour seemed to cease in about May 2007, only to resume in September, though in a somewhat modified form. During the course of 2007, he and other GSA Capital personnel attended meetings with the Authority at which his observations were described in more detail. In his first witness statement he set out a number of examples, wholly consistent with the more generic description given by Dr Townsend, to which we come shortly, and we do not think we need add to the length of this decision by giving details of those examples. We should, however, add that Mr Shvorob said that the behaviour he observed extended not only to the examples he gave, but was widespread.

79. He was of the view that the behaviour inevitably had an impact on other market participants, by misleading them not only about general supply and demand, but by giving, for example, the false impression that a positive or negative announcement about a particular stock had been made. By misleading users, he said, the behaviour caused them to place orders they would not otherwise have placed, or to cancel or amend orders they would otherwise have left, or left unamended, on the order book, and in short to alter their own behaviour. He estimated that GSA Capital alone may have lost as much as US$30,000 per day as a result of this conduct. We interpose that, although we have no doubt it was advanced in good faith, we recognise this figure to be no more than an estimate, and we have no clear evidence from which we might make a confident finding about the scale of the loss to GSA Capital or any other market user.

80. Dr Townsend's team's function is to analyse market movements with a view to identifying inefficiencies and, with them, trading opportunities. It was apparent from his evidence that the team is heavily dependent on computers and, to some extent at least, it is engaged in the kind of algo trading which Dr von Pommern-Peglow identified. The computer programs the team uses focus particularly on what Dr Townsend called "tail events", that is cases where a price moves more than might be expected. As he described them, the programs are extremely sensitive to anomalies, and are capable of detecting them almost instantaneously.

81. He told us that he observed an unusual pattern of trading, of the kind we have already described, as early as January 2007 (that is, at the beginning of the relevant period); it was, he said, very obvious because it was widespread, consisting of tens of thousands of orders, and because it affected a lot of stocks quoted on the LSE, initially those which were less liquid, but later including

stocks in which there was considerable liquidity, including many within the FTSE 100 index. There were, he said, signs of similar activity on continental exchanges. He and his team undertook some analysis of a selection of the orders, affecting typically between 10 and 20 stocks each day, which the computer programs had identified as suspicious. He provided us with four illustrative examples, which we do not think it necessary to describe for present purposes as Dr von Pommern-Peglow did not challenge either the analysis or the conclusion that what it demonstrated was consistent with the kind of manipulative dealing of which the Authority complains. In March 2007 UBS's compliance department informed the Authority and the LSE of their suspicions; the information, coupled with that provided by GSA Capital, led to the actions which Miss Cowan described.

82. It is worth including Dr Townsend's own description of what he and his team observed, both as a representation of the perception of another market user, and as a convenient summary of the core of the Authority's case on the characteristics and effect of the relevant conduct. Of the orders' characteristics he said they consisted of:

> "…a series of limit orders placed alternately on one side of the … order books and then the other. For example a whole set of limit buy orders would be put on one side of the book, then they would be removed quickly and then, subsequently, a whole set of limit sell orders would be put on the other side of the book a short time later. The quantity of each of these orders was not abnormally large by comparison to the 'normally' traded quantities of the stock in question; however because several of them were 'stacked' on one side of the order book the total volume could be quite large. The orders would build up over something like a minute but would be cancelled very quickly (typically within a matter of seconds). These buy or sell orders would be at different prices, and most of them would not be near the best quotes on the order book [*ie* the touch], and therefore would have little chance of being executed within the time frame for which they existed.
>
> The placing of the orders deep within the order book—away from the best bid and ask or 'touch' price—indicates to me that whoever is placing these orders does not want to execute them. Typically if you wish to buy stock you have to price the order at the level of the best bid. If you price at 1 'tick' (an incremental price movement such as one penny) below (less aggressively than) the bid, you will have to wait much longer to get executed and the sequence goes on, if you price at 2 ticks below the bid you have to wait even longer, and 3 ticks even longer. Whoever was placing these orders was pricing orders in at 5, 6 or 7 ticks away from the best prices and, in the absence of some dramatic price movement such as that associated with some news item, you would typically have to wait some substantial time to get executed at these prices because you would have to wait for the price to move naturally to that level. The orders in question here persisted or 'lived' on the order book for only a very short period of time, which given their price distance from the best bid or ask price meant they were very unlikely to execute."

83. Dr Townsend gave a number of examples which, again, we do not think it necessary to repeat. He went on to describe the effects of the behaviour he had observed. He said that:

"the price of stock in question …will oscillate in time in a very unusual way … when these activities are happening, the prices move up and down, very rapidly, in something akin to a saw-tooth pattern.… Although in absolute terms the price oscillations are quite small, the frequent and random nature of the changes are [*sic*] significant.… The rapid change (removal) of the cumulative volume of the orders can be significant enough to affect the stock price so that it moves up or down by several ticks. In simple terms if you take away the entire buy side of an order book (*ie* the bids that comprise the demand from investors for the stock) the price falls because there is no-one bidding. Thus these orders, which are sufficiently far from the touch price so that they are unlikely to be executed, still very much influence the appearance of demand or supply for the stock.…

The second observable effect is that the liquidity in the market place for the stock at any instant, as represented by the order book, will be artificially increased for the short period of time when the offending orders in question are placed on either the bid or the offer side of the order book. No individual order ever looked excessively large or out of place. However, and this is a key point, the total volume summed up over all the orders (say 5) was large enough to distort the overall liquidity on the book. Therefore anyone looking at the order book at any instant may not notice anything unusual; this behaviour is noticeable only when one looks over time and sees the cyclical pattern of insertion and removal.

… considered separately the individual characteristics of this behaviour are not necessarily of themselves unusual. The size of the individual orders is not excessively large, the fact that the orders are not priced at the best price is not unusual and orders existing on the order book for a short time is common. However it is the combination of these characteristics *ie* cumulatively very large volume priced away from the 'touch' with a short lifetime, that is highly unusual and therefore prompts questions as to the intention behind the orders and leads me to the conclusion that there is no intention to trade these orders."

84. Dr Townsend did not attempt to quantify the impact of the activity on UBS's own profit and loss, but said "certainly there has been significant revenue loss and missed opportunity cost. We have been forced to tune down or switch off revenue streams."

85. Mr Krishnan described Swift Trade's relationship with Merrill Lynch. Its DMA service is available to its clients to enable them to deal either directly in securities or, as in Swift Trade's case, in synthetic products. The platform provided to Swift Trade was the same as that provided to other similar clients. The advantage to a client trading in synthetic products (whether by this means or in other ways), as we have said, is that it incurs only dealing fees, but not stamp duty, and does not need the cash resources which would be required if it were to deal in the underlying securities. It is, however, the usual practice, with very limited (and for present purposes irrelevant) exceptions, for the counterparty—in this case Merrill Lynch—to hedge the trade in the market; and these synthetic trades accordingly appear to other market users in exactly the same way as ordinary trades. In practice, given the volume of Swift Trade's trades, Merrill Lynch (as it is accepted Swift Trade knew) automatically and immediately hedged all of them.

86. Swift Trade was already a user of similar facilities provided by Merrill Lynch in the United States when it became a client in London in early 2006, although its first DMA trade did not take place until May 2006. Mr Beck and a colleague, Mr Charles Kim, a senior Swift Trade manager, dealt with the relationship between Swift Trade and Merrill Lynch at the most senior level, while Mr William Morgan, a business analyst and the Manager of Business Development and Operations at Swift Trade during the relevant period, represented Swift Trade on day-to-day matters. We shall say more about Mr Kim and Mr Morgan later. The contracts between Merrill Lynch and Swift Trade were in the ISDA form we have already described (see para 29 above). They provided for Swift Trade to pay fees, including a very small charge (typically one penny) for each order, amendment or cancellation; thus dealing costs were minimal. The agreements permitted Merrill Lynch to hedge trades, and imposed a number of obligations on Swift Trade, including one to permit only properly trained persons to use the facility, and another to screen orders in order to ensure they complied with set limits and did not lack commercial purpose. There was, in addition, a warranty in these terms:

> "Swift Trade warrants and agrees that it shall not place any orders which could directly or indirectly: (i) have the effect of manipulating or distorting the market for securities, (ii) cause any false or misleading impression in relation to the price or volume of, or level of supply or demand for, securities …."

87. Mr Krishnan's understanding was that Swift Trade conducted its business by means of dealers based in branches all over the world, but that was not a matter with which Merrill Lynch was concerned provided Swift Trade performed its obligations. It was in any event impossible for Merrill Lynch to detect the origin of any order since it was routed to Merrill Lynch by means of a single Swift Trade server based in Canada.

88. Mr Krishnan's personal involvement in the relevant trades began in March 2007, but initially only in the indirect sense that he was aware of the LSE investigation, which was handled for Merrill Lynch by Mr Walker. In April 2007 he attended a conference call, in which (among others) Mr Walker, Mr Beck, Mr Morgan and two members of the LSE staff were also present. The topic of discussion was the LSE's concerns about Swift Trade's activities, which Miss Cowan described, and the conference led, after a good many further exchanges with which Mr Walker dealt in more detail (and which we summarise below), to the implementation, or claimed implementation, in June 2007 by Swift Trade of controls which the Dealers were required to respect. In the meantime Merrill Lynch was sufficiently concerned about Swift Trade's activities to threaten to withdraw its facilities, although this did not immediately happen as Merrill Lynch was initially persuaded that Swift Trade's new controls were adequate. It was apparent from Mr Krishnan's evidence that Merrill Lynch's relationship with Swift Trade had become somewhat strained and in September 2007 it concluded that the cost to it of monitoring Swift Trade's trading was too great, that the relationship had become both risky (in respect of Merrill Lynch's own compliance obligations) and unprofitable, and that it should be terminated.

89. Mr Walker's role was to act as a link between Merrill Lynch and Swift Trade, following the LSE enquiry and after the Authority's staff had also taken an interest in the matter, and to negotiate and ensure the implementation of changes in practice on Swift Trade's part. At first, he assumed that Swift Trade had acted correctly but it was clear from his evidence that within a short time of his becoming involved he identified concerns. He endeavoured to address those concerns in order to ensure that Swift Trade and the Dealers did not infringe any of the relevant rules. It was apparent from his evidence that the particular aspects of the conduct which concerned him most were the volumes of orders, and the brevity of the periods for which they remained on the order book. The controls he insisted that Swift Trade implement were designed to restrict the Dealers' ability to place orders in that way. He told us that he received various assurances from Swift Trade about the changes in practice it had implemented, but notwithstanding those changes further episodes of suspect activity occurred. It is apparent that there was a considerable amount of dialogue between Mr Walker and Swift Trade, particularly Mr Morgan, and we were left with the distinct impression that it was in large part Mr Walker's insistence on the implementation of suitable controls, and his monitoring of their effectiveness, which led to Swift Trade's decision to change its DMA provider from Merrill Lynch to Penson in the hope (as we shall explain) of freeing itself from some of those controls.

90. Mr Pickering told us that Swift Trade had been a client of Penson since 2004, but the relationship was with Penson's office in Dallas, Texas, and Swift Trade used the DMA facilities Penson provided only on overseas markets. In June 2007 (when, as we have said, Swift Trade's relationship with Merrill Lynch was becoming difficult) it approached Penson with a view to using its services on the LSE as well. It would have been possible to extend the existing agreements between the two companies to cover such dealing, but it was decided instead to enter into fresh agreements, which were in standard form, and, as we have mentioned, for present purposes identical to those between Swift Trade and Merrill Lynch. They required Swift Trade, in particular, to comply with all applicable regulatory requirements and to restrict access to the trading platform to those properly authorised. The agreements made provision for Penson's hedging of the CFD orders placed by Swift Trade, and Mr Pickering was confident that Swift Trade was well aware that Penson would routinely hedge all Swift Trade's orders. All the arrangements were made between Penson in London and Swift Trade in Toronto; the contacts there were Mr Beck and Mr Morgan.

91. The reasons given by Swift Trade for its change of DMA provider, Mr Pickering told us, related to price and speed of service; nothing was said about the fact that Merrill Lynch had insisted upon the imposition of controls because of its concerns about the nature of the trading, or about the LSE enquiries. He said he was surprised by that omission; it was an expectation that a well-governed regulated firm (as Penson took Swift Trade to be) would be candid. Had full disclosure been made Penson would have undertaken further due diligence, and might well itself have imposed controls.

92. Penson was aware that Swift Trade was itself providing facilities to Dealers based around the world, but it did not have any contact of its own with the Dealers, and it was apparent to us from Mr Pickering's evidence that he at least

was unaware of (and unconcerned about) Swift Trade's relationships with them. He did, however, know that the Dealers' orders were routed electronically, and therefore virtually instantaneously, through a Swift Trade server, and then through the Penson server in Dallas, before arriving at Penson's server in London. Swift Trade was permitted to engage only in day trading, and was not allowed to hold overnight positions. Very occasionally that rule was breached, when a Dealer found it impossible to close a position before market hours ended, but nothing turns on the breaches for present purposes.

93. There were some minor differences between Merrill Lynch's and Penson's handling of Swift Trade's, and the Dealers', orders, but none of significance to this reference.

The expert evidence

94. We also found Mr Martin and Professor Linton to be reliable and credible witnesses, but regret to have to say that we found Professor Bond's evidence rather less convincing, and in some respects implausible. We were left with the impression that, while he was in no way untruthful or attempting to mislead us, he was somewhat partial, and this fact made it difficult for him to justify some of his opinions in cross-examination. Where there is a conflict between Professor Bond and Professor Linton or to a lesser extent (since there was little overlap of their disciplines) Mr Martin, we prefer the evidence of the latter to that of Professor Bond.

95. Mr Martin examined the examples of trading activity identified in their witness statements by Miss Cowan, Dr Townsend, Mr Hacon and Mr Shvorob and concluded from it that Swift Trade could have had no real desire to trade the large orders it placed. The particular factors on which he relied in reaching that conclusion included some we have already mentioned, particularly the fact that a large proportion of the orders placed were placed away from the touch price and were short lived, and the evidence that Swift Trade was testing the market with small orders. He was of the view that the number of trades, and the similarities in the pattern of trades, were such that they could not be accounted for by coincidence, and must be the manifestation of a strategy.

96. He added that Swift Trade's imposition of strict loss limits (that is, the Dealers were permitted to lose no more than a small sum, typically £100 or £150, in a day, a limitation which Swift Trade had itself identified to the Authority) and its policy of preventing positions from being held overnight was incompatible with a desire that the larger orders should be executed, since their execution would make it very difficult to avoid breaching those restrictions. An adverse movement of only 1p in the price of a share for which an order for 20,000 (a common volume) had been placed would, alone, breach the Dealer's daily loss limit. This fact, too, pointed to the conclusion that the large orders were not intended to execute.

97. It was, he said, an inevitable conclusion that putting in orders which there is no intention or likelihood of executing would create a false and misleading impression, because other market participants (like the Dealers, watching market movements in "real time") would assume that the orders were genuine, and react

accordingly. Their reactions would, in turn, cause the prices of the affected stocks to reach artificial levels. While Swift Trade was able to profit from those artificial levels (by, as we have said, buying or selling at advantageous prices by means of the smaller orders placed on the "other side" of the order book), others, and particularly algo traders, would suffer corresponding losses.

98. It is convenient at this juncture to mention Mr Otty's observation that much the same point had been made by two other expert witnesses on whose evidence Swift Trade had previously relied, though it did not arrange for them to give evidence to us. The first was Dr Fitzgerald, to whom we have already referred, and the other Mr Patric de Gentile-Williams. Although Mr de Gentile-Williams challenged various parts of the Authority's case, he nevertheless said in his report that it was "correct in its assumption that the strategy was indeed implemented repeatedly in a number of illiquid and thinly traded stocks with the intention of making short term profits by wrong footing a specific set of markets participants and thereby making a series of very small profits."

99. The thrust of Professor Linton's evidence was that the modelling strategy adopted by the Authority—the sampling exercise as we have described it—was appropriate as a test of whether Swift Trade's activity had an effect on prices, and that the results obtained by that process provided strong evidence that the prices of the stocks in relation to which the activity occurred had been affected—in other words, the statistical material which was available demonstrated not only that a strategy aimed at manipulating prices had been deployed, but that it had (with occasional exceptions) achieved its purpose. As Professor Linton's evidence on the essential points coincided with the evidence of every other witness apart from Professor Bond, we do not need to say any more about it.

100. Professor Bond took the view that price manipulation of the kind on which the Authority relies was not made out, and that the form of trading in which Swift Trade or the Dealers engaged, which he acknowledged to be correctly demonstrated by the graphs and other material before us, could not meaningfully be differentiated from other types of conduct which were accepted to be in accordance with approved market conduct. We have already mentioned (see para 65 above) his criticism of "iceberg" orders and of algo trading, both permitted practices; there was no reason, he said, why the placing of large volumes of orders, all of which were visible and all of which were capable of being executed, should be viewed in any different light. The purpose of day trading such as that in which Swift Trade engaged was to profit from price movements by, in effect, being quicker, cleverer or luckier than others. That, he said, was what algo traders attempted to do, and Swift Trade's Dealers were in the same position.

101. Professor Bond also sought to support Swift Trade's position by pointing to the controls implemented by it in response to regulatory concerns, and the concerns of its DMA providers, which we describe elsewhere in this decision. Those, he said, were indicative of an attempt to ensure that the trading was carried out responsibly and in full compliance with market rules and practice.

102. It is convenient to observe at this point that, for the reasons which we explain below, we reject Professor Bond's evidence. He was reluctant to address the question whether the method of trading adopted by Swift Trade was designed

to move prices, rather than to profit from movements which occurred naturally, and he was alone in thinking that Swift Trade's strategy was legitimate and in accordance with market practice. If there should be any room for doubt that he is mistaken, it is dispelled by the documentary evidence to which we come next.

5 *The documentary evidence*

103. The answers to issues (6) and (7) (whether Swift Trade or the Dealers, independently, were placing the orders and whether Swift Trade can avail itself of the s 123(2) defence) are very substantially dependent on an analysis of the available documentary evidence, coupled with the evidence, only indirectly before 10 us, which was given to other regulatory bodies, and the conclusions to be drawn from that evidence (which also throws further light on issues (4) and (5)). We had nothing else from Swift Trade, a fact on which the Authority placed some emphasis; it argues that Swift Trade's failure to produce evidence to it, to the tribunal and to the other regulatory bodies which have been involved in the matter 15 speaks for itself. Dr von Pommern-Peglow retorted, rather lamely if we may say so, that it was for the Authority to prove its case, and that Swift Trade had no obligation to demonstrate anything. For the reasons we have already given, although that proposition may be true in relation to the Authority's own case, it is for Swift Trade to demonstrate that the s 123(2) defence is made out once market 20 abuse is shown to have occurred.

104. Our attention was drawn in particular to email exchanges between Mr Morgan, Mr Kim, Mr Bill Nie, another senior Swift Trade official, and Mr Beck. Mr Morgan was the principal Swift Trade contact with both of Swift Trade's DMA providers, Merrill Lynch and Penson. As none of Mr Morgan, Mr Kim, Mr 25 Nie and Mr Beck gave oral evidence we have no first-hand explanation of Swift Trade's strategy beyond what is set out in the emails and other documents referred to in them. Mr Morgan did give evidence (adverse to Swift Trade's case before us) in the course of a United States enquiry into Swift Trade's conduct. The evidence was, indeed, supportive of the Authority's position, in particular that 30 Swift Trade orchestrated the trades. We were told that Mr Morgan had been asked to give evidence before us but had declined, because (it was said) he was concerned about the personal consequences for him if he did; he is not compellable as he is outside the jurisdiction. We have considered the evidence he gave in the US (and describe it briefly below) and, as it is consistent with other 35 evidence before us which Dr von Pommern-Peglow was able to challenge, have taken it into account in reaching our conclusions even though Mr Morgan was not subjected to cross-examination.

105. It was Swift Trade's practice to communicate with the Dealers by email, and several examples of such communications were provided to us. The volume was 40 such that we shall set out only a small cross-section. Some of the communications were described as "trader alerts", advising of and commenting about (among other things) the regulators' and others' concerns which had come to Swift Trade's notice. The first such alert to which we were referred was issued on 22 March 2007, in response to the concerns, raised by the LSE and communicated to Swift 45 Trade by Merrill Lynch, with which we have already dealt. It read as follows:

> "Market Supervision at the LSE has complained about certain trading practices. Under LSE rules, orders placed in the market must remain there for a 'reasonable' time before being cancelled. The practice of placing an order and cancelling it before another trader has an opportunity to trade against it is forbidden."

106. Mr Calvin Amell of Swift Trade's Ottawa office sent an email to Mr Morgan in response to this alert on 23 March 2007. It read:

> "We have heard rumours that the offices making ALL the big bucks on LSE have been doing that. Is this HO cya [Head Office "cover your ass"] or will you guys be proactive or reactive? Don't tell me you didn't think it was strange that ALL of a sudden a couple of offices were making LSE work when others couldn't."

107. Mr Morgan replied on the same day:

> "This is what we call a cover-our-ass-alert. I know exactly what's going on with the LSE trading. The beautiful thing is that they aren't being too obvious about it; so, there's no perception of manipulation."

108. In a further email of 23 March 2007, Mr Amell wrote:

> "So long as HO is making money don't change a thing until we get caught? Hmmmmm, I think we've been in this situation before with an office in Quebec …"

109. The Authority argues that these messages, and others in similar vein, make it clear that Swift Trade was well aware of the manipulative practices which were being used, and that the alerts it issued, and email correspondence which appears to show concern about illicit activity, were not intended to be taken seriously, and not intended to bring such practices to an end; they were no more than cosmetic, produced with an eye to their possible examination by regulators.

110. It was at about the same time that Merrill Lynch was beginning to express concerns, motivated in part by the approaches to it by the LSE and the Authority with which we have already dealt. Among a series of such expressions of concern is an email of 2 April 2007 from Mr Walker to Mr Morgan, in which he explained in some detail what was the perceived activity which was giving rise to the concern (for which he used the term "layering"), expressed the view that what was being done was likely to give a false impression of demand or supply, and requested that in future the Dealers' conduct should be modified, in particular by leaving orders on the order book for longer periods. In an internal email written by Mr Morgan a few minutes later, he stated:

> "Seems the FSA has taken a strong dislike to the practise of layering – that is closing the spread with multiple orders then killing all the remaining orders once one is filled ... It seems we may need to issue another alert about closing the spread by layering orders … can you work on a carefully worded alert on this issue …".

111. Further emails shortly afterwards contained a discussion about the possibility of regulatory action: Mr Kim asked whether Merrill Lynch had mentioned what "the FSA is threatening if we don't stop." Mr Morgan replied "No he didn't. I'm not sure we're at the point of threats; in truth, I'm not sure how

the FSA deals with these situations." On 5 April 2007 Mr Nie sent an email to Mr Morgan, which was copied to Mr Beck:

> "The LSE issues look very serious. Many traders here place orders to close the spread, however we are not cancelling the rest while filling one order. We place orders on both sides. As we notice, some traders from other offices place some stupid basket orders, which will be automatically cancelled when one order in it is filled. Please not let them place basket orders on LSE stocks.
>
> If our LSE trading is too risky to affect the whole company, I will stop it since we can still make money from NYSE and the coming new markets. Or we are keep trading until LSE complain our trading?"

112. The Authority relies, in addition, on an email of 16 April 2007 to ITG, an independent US broker, in which Mr Morgan made it clear that, in his view at least, Swift Trade and its clients were indistinguishable. In that email he said "I represent OMS (Swift Trade), [BRMS], and all of Swift Trade's clients. We are effectively one organisation".

113. By May 2007 Mr Morgan was showing some concern of his own that the Dealers' activities were too easily identified. On 23 May he sent a further email to Mr Beck and Mr Nie, in which he commented about a spreadsheet provided by Merrill Lynch: "you can see the orders entered and the fills—it's quite obvious what they're doing." Mr Nie's response was that "I will give the sheet to all my LSE traders and improve our strategy, thanks".

114. Later that month Swift Trade was considering the introduction of new software which was programmed to prevent the cancellation of an order within three seconds of the cancellation of another order placed in respect of the same security and on the same side of the order book. Mr Nie sent an internal email expressing his dissatisfaction with the proposed software: "if those big orders can not be cancelled, our strategy is a losing one; losing ten to win one". It did not become clear to us whether the software was introduced, and if so whether or not it was modified in order to eliminate that apparently undesired effect.

115. What is clear is that the activities continued. On 25 July 2007 Mr Morgan emailed Mr Beck, following yet further expressions of concern from Merrill Lynch, counselling not a cessation of what was being done, but a reduction in the size of orders. The Authority argues that his plain purpose was to make the nature of the activity more difficult to detect. The email contained this passage:

> "ML is now getting some 'noise' … posting these large orders and never executing anywhere near the posted size ... Tony [*ie* Mr Walker] now insists that the trader has to stop doing this. I'll call [the Dealer's supervisor] about this – just to tell the guy to post smaller sizes. I think if he posts 60k instead of 150k he would probably be ok."

116. By August or September 2007 Merrill Lynch's concerns had increased to such an extent that, we infer, Swift Trade realised its DMA facility was likely to be withdrawn and began to look in earnest for a replacement provider, in the event Penson. It was not long, however, before Penson also began to express concerns, despite its having been assured by Swift Trade that it would respect market rules. The LSE, too, was monitoring Swift Trade's conduct, and on 3 December 2007 it

issued the notice to which we have already referred, which was motivated by its perception of that conduct. It drew particular attention to the prohibition of layering. On 6 December, Mr Rob Long, Penson's Head of Equity Finance & Trading, sent an email to Mr Morgan which contained this passage:

> "The [LSE] notice is quite specific and refers to the practice of layering …We requested that these practices ceased forthwith, but unfortunately this has not happened, and I note that this morning's trading activity included … layering.
>
> Once again I request that you desist from these activities with immediate effect. Your failure to do so will result in the closure of your trading facility at 2 pm today."

117. Mr Morgan replied the same day to say that the activity had stopped, with immediate effect, but Mr Long was plainly not satisfied as he sent a further email early on the following day:

> "I note that despite your assurances that the practice, described in the LSE Notice, as layering, has stopped, it patently has not. I looked at your trading in Barclays this morning, just as an example. Although there does not appear to be any one share trading, layering is still occurring.
>
> This activity must stop immediately. I will have no choice but to withdraw your trading facility."

118. Swift Trade's DMA facility was not stopped immediately, one can only assume because Penson accepted its assurances that the practice to which Penson objected would be stopped. However, only a week later Mr Nie was himself expressing further concern, in an email to Mr Beck and Mr Morgan:

> "We still found some guys in the LSE market used our strategy to make LSE stocks. And my traders told me that they can still make some LSE stocks too using three orders. However, I told my traders to stop making LSE stocks, since I do not want to bring any trouble for you. Will [Mr Morgan], please tell other offices stop this strategy in LSE markets, since they can have two or more traders make a LSE stock together."

119. There are several more email exchanges in a similar vein, and although we were taken to them we do not think it necessary to deal with all of them in detail since our doing so will add nothing to understanding. The important point is that, despite Dr von Pommern-Peglow's best efforts to persuade us otherwise, the emails seem to us to speak for themselves, and in the absence of contrary evidence, or of other emails or documents casting a different light upon them (of which Swift Trade produced none) we see no reason to view them otherwise than at face value.

The Authority's case

120. The Authority's argument in respect of these exchanges is that it demonstrates that, from the first expression of concern by the LSE in March 2007, and throughout the relevant period, Swift Trade was aware of the illegitimacy of the trading strategy which was being deployed, and was concerned to avoid regulatory scrutiny, but nevertheless continued to direct and encourage the strategy, at the same time providing advice about how its detection could be

avoided. It argues that the exchanges also show that the motivation was the profits that the illicit activity generated: as we have said, it is common ground that Swift Trade took a share of the Dealers' profits from their trading activities. This material taken on its own, it says, provides strong support for its case that Swift Trade provided informed direction and control; and when it is viewed with other material it becomes compelling.

121. That other material consists largely of what has been provided to other regulators. As this material was not challenged we can deal with it briefly. Mr Morgan, Mr Kim and Mr Beck all gave evidence before United States regulatory authorities; Mr Morgan's evidence is the most important. What he said shows, and in our view unequivocally, that both Swift Trade and Mr Beck knew that the Dealers were engaging in layering. He explained that "layering spoofing strategies" were "shared by the home office with other offices", that Mr Kim and Mr Beck had "realised that the information, that this trading strategy would not last forever in terms of profitability and wanted to profit from it as much as possible so long as the strategy worked", and that Mr Kim had embarked on a "long trip to China" to tell other offices about it. There was further evidence before those regulators supporting the proposition that Swift Trade's senior officers had disseminated the trading strategy to Swift Trade's offices around the world.

122. The Authority's argument is that the combination of the material available and the failure of Swift Trade, despite its having referred the RDC's decision to the tribunal, to engage with the issue indicates that it would be not merely wrong but irrational for us to do anything other than find direction and control to be made out. It adds that Swift Trade's claim that the Dealers were acting independently, in a manner which absolves it from direct responsibility for what occurred, is false and amounts to nothing more than a smokescreen. It is, moreover, an ineffective smokescreen, since s 118(1) is engaged whether the person concerned has acted alone, or jointly or in concert with others (an argument on which we have already expressed our conclusions, in a different context, at para 38 above). Even on Swift Trade's own case, it says, that is the position here.

123. If the evidence of the emails is right, the Authority adds, it is impossible for Swift Trade to bring itself within s 123(2), by showing either that it "believed, on reasonable grounds, that [its] behaviour" did not amount to market abuse, or that it had taken "all reasonable precautions and exercised all due diligence to avoid behaving" in such a way.

Swift Trade's case

124. As we have explained, Swift Trade maintains that it was merely providing a platform for independent Dealers. It did not produce any evidence, oral or documentary (for example the contracts by which it offered the use of its server to the Dealers), to support that proposition, and we are left to draw inferences from the email exchanges. Likewise, the absence of any evidence from Swift Trade about the purpose behind its trading, to support its claim that it was undertaken for legitimate reasons, made it impossible for Dr von Pommern-Peglow to mount any meaningful challenge to the evidence produced by the Authority and, as we have

said, he was able to make no inroads of any significance in the course of his cross-examination.

Conclusions of fact: issues (4), (5), (6) and (7)

125. We found that the graphs, the other material we saw and the evidence we have outlined lead compellingly to the conclusion that the trading we have described was deliberate, manipulative, designed to deceive other market users, successful in that aim, and undertaken for motives of profit. The repetition was too frequent, and the patterns too similar, for the appearances to be attributable to coincidence or some other chance event, and we have no doubt it was the product of a directing mind.

126. There is in our view nothing to support Swift Trade's contention that it was acting as no more than a subsidiary DMA provider. As we have already said, we saw no evidence of arm's length agreements between it and the Dealers and, of course, had no oral evidence on the topic. By contrast, the email exchanges, particularly but not only that to which we refer at para 112 above, represent, we are satisfied, a compelling indication that, whether the Dealers were Swift Trade's employees or in some other relationship with it, they were acting as part of Swift Trade's overall organisation, and in accordance with a strategy of which Swift Trade was not only well aware but which it devised and encouraged. We agree with the Authority that the trader alerts were no more than cosmetic.

127. We are also satisfied from the content of the various email exchanges to which we have referred, and from the failure of Swift Trade to disclose to Penson either the reasons for its ceasing to use the DMA facilities it had previously enjoyed with Merrill Lynch or the fact that the LSE and the Authority had been enquiring into its activities only a few months before, that Swift Trade's conduct was designed to conceal what it was doing from regulators, and that the controls it implemented at the insistence of its DMA providers were little more than a gesture made for the purpose of securing continuing facilities and not with any true intention of restricting the Dealers' activities. There was in addition evidence, as the email exchanges show, that the restrictions and the warranties which we mentioned at para 86 above were disregarded.

128. There is no evidence before us from which we could draw the conclusion that Swift Trade had, or could reasonably have thought it had, grounds for believing that its conduct was not abusive; on the contrary, the evidence points very much to the conclusion that its officers and managers knew very well that its conduct was not legitimate and that, far from taking steps to prevent such conduct, they actively encouraged it.

129. It follows from those conclusions that Swift Trade's conduct was such as to come within the descriptions set out at paragraphs (a) and (b) of s 118(5), that the transactions in question were not effected for legitimate reasons, and that Swift Trade was correspondingly guilty of market abuse. It also follows that s 123(2) does not assist it.

130. That being so, it is unnecessary to examine the Authority's alternative argument that, if s 118(5) was not offended, s 118(8) was; but as Dr von Pommern-Peglow raised the point we should make some brief observations about

it. It is clear from the wording of sub-s (8), first, that it does not capture behaviour which falls within sub-s (5)—thus the two are mutually exclusive and a single course of conduct can offend only one of the subsections—and, second, that it is wider in the scope of the activities it captures than sub-s (5), while the test is stricter, in that it is necessary to consider the effect of the conduct from the perspective of a regular user of the relevant market, who must be assumed to be experienced and knowledgeable. That the test is met as a matter of fact in this case is clear from the findings we have already made: Mr Shvorob and Dr Townsend, plainly, are regular users of the LSE within the meaning of the subsection, and both were deceived by Swift Trade's conduct about the true demand for the relevant shares.

131. The question remains, however, whether it is open to the Authority, before us, to rely on a provision to which no reference is made in the decision notice, and for us to reach the conclusion that, if Swift Trade's conduct did not fall within sub-s (5), it fell instead within sub-s (8).

132. The parts of s 133 of FSMA (which dictates the extent of the tribunal's jurisdiction) relevant to this point are as follows:

> "(1) This section applies in the case of a reference or appeal to the Tribunal (whether made under this or any other Act) in respect of—
>
> (a) a decision of the Authority;…
>
> (2) In this section—
>
> 'relevant decision' means a decision mentioned in subsection (1)(a) …; and
>
> 'the decision-maker', in relation to a relevant decision, means the person who made the relevant decision.…
>
> (4) The Tribunal may consider any evidence relating to the subject-matter of the reference or appeal, whether or not it was available to the decision-maker at the material time.
>
> (5) The Tribunal must determine what (if any) is the appropriate action for the decision-maker to take in relation to the matter referred or appealed to it.
>
> (6) On determining the reference or appeal, the Tribunal must remit the matter to the decision-maker with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination."

133. As we have already pointed out (see para 49 above) the tribunal's task is to reach its own conclusion, and not merely to consider whether the RDC's decision was reasonable. It is also plain from s 133(4) that the tribunal is required to consider evidence, and by necessary implication come to a conclusion about, "the *subject-matter* of the reference"; and from sub-s (5) that it must determine the appropriate action "in relation to the *matter* referred". If the draftsman had intended to confine the tribunal to the four corners of the decision notice he could easily have said so. Instead, he used a different term: subject-matter, or matter. In our view he did so in order to make it clear that, while the tribunal cannot embark on a wide-ranging enquiry into unrelated topics, it may hear evidence and argument different from or additional to the material available to the RDC, and

come to its own conclusions. The only limitation is that it must confine itself to the "matter"—in this case the trading conduct—which is the subject of the reference. It must equally follow that if the tribunal concludes that "the appropriate action for the decision-maker to take in relation to the matter referred" is to make a determination in accordance with s 118(8) rather than s 118(5), it may do so. We do not perceive, either from that analysis or from what Dr von Pommern-Peglow said, that any unfairness results from that approach; in some cases it might be to an applicant's advantage.

The Canadian proceedings

134. Dr von Pommern-Peglow emphasised that the Authority was aware of the OSC proceedings, just as the OSC was aware of the Authority's investigation: the two enquiries were not, therefore, carried out in isolation. The principles of *lis pendens* and international comity, he said, required the tribunal to respect the agreed facts recorded in the OSC settlement, particularly those relating to Swift Trade's business structure, its relationship with its customers and traders, the operation of its trading platform, and its regulatory behaviour. In other words, it would be an abuse of process for the tribunal to engage in a re-evaluation of the matters that have been agreed between Swift Trade and its home regulator.

135. It followed, he said, that the tribunal is required to take notice of, and not make any finding contrary to, the terms of the OSC Settlement Agreement and, in particular, it should heed the fact that the OSC did not find either that Swift Trade directed the trading of its customers or traders, or that it had engaged in manipulative strategies or disseminated manipulative strategies to its customers and traders.

136. We agree with Mr Otty that these arguments are hopeless, and we have no hesitation in dismissing them.

137. It is, first, worth pointing out that, at para 4 of the Settlement Agreement, it is recorded that "The Respondents [among whom were Swift Trade and Mr Beck] admit the facts set out in Part III of this Settlement Agreement solely for the purposes of this Settlement Agreement." It does not seem to us that Swift Trade can rely on agreed facts when it suits it to do so, while retaining the right to have them excluded from consideration as agreed facts when it does not.

138. Second, and more importantly, while it is true that there is no finding by the OSC that Swift Trade directed the Dealers or engaged in manipulative strategies of the kind alleged by the Authority in these proceedings, it is equally the case that there is no finding that Swift Trade had not engaged in such practices: in other words, the Settlement Agreement is silent on the point. The reason for that is the one identified by Mr Otty, namely that the OSC was not looking into Swift Trade's trading practices, but into its compliance procedures. In that context it made serious criticisms of both Swift Trade and Mr Beck, effectively finding that they, and particularly Mr Beck, acted with almost complete disregard of the Ontario regulatory system, principally in the areas of registration, supervision and record-keeping. It mentioned "illegal trades" and "questionable trading", but only as examples of conduct which the inadequacy of Swift Trade's controls would prevent it from detecting. There is no overlap between the two investigations, and

we find nothing in the Settlement Agreement or in any other aspect of the OSC enquiry which should preclude the Authority's, or our, examining Swift Trade's activities on United Kingdom markets.

Penalty

139. As we have mentioned, the RDC imposed a penalty of £8 million. For reasons we have already discussed, it is not our function merely to accept or reject that figure; we must come to our own conclusion about what the appropriate penalty is, in the light of the evidence and other material available to us. We should, however, record that Mr Otty sought to support a penalty of £8 million, while Dr von Pommern-Peglow argued that such an amount was disproportionately high.

140. It will be readily apparent from what has gone before, without further elaboration and still less repetition, that we have concluded that the conduct of which Swift Trade was guilty amounted to a cynical course of intensive manipulation of the LSE (we leave other markets out of account) for the benefit of Swift Trade and the Dealers within its network, that it was carried out over a period of a little over a year, that attempts were made to conceal it, and that, far from demonstrating remorse, those controlling Swift Trade have done everything possible to escape the consequences of their actions. Of its kind, it is as serious a case as might be imagined, and there is nothing which could possibly be said by way of mitigation. Dr von Pommern-Peglow recognised, very realistically, that an attempt to mitigate would be futile.

141. He also did not produce, as at one point he indicated he would, copies of Swift Trade's financial statements showing (as one might assume) inability to pay a penalty of such magnitude. There was some rather inconclusive evidence that Swift Trade's resources when it was dissolved amounted to less than £2 million. We cannot, however, have any confidence about the reliability of that evidence, and we proceed accordingly on the basis that there is nothing before us to show that it, or its parent, is indeed unable to pay a substantial penalty. We bear in mind too that the Authority's estimate of Swift Trade's gains, and the evidence we had of losses suffered by UBS and GSA Capital (and other market users too may have sustained losses) was nebulous.

142. We do not, therefore, approach determination of the penalty from the viewpoint of ability to pay, nor by reference to the profits made by Swift Trade or the losses sustained by others. What is clear, as we have said, is that this was a prolonged, cynical course of market abuse committed by a company which, as the OSC Settlement Agreement shows, exhibited a wholesale disregard of regulatory requirements: it was, in short, a company which acted as if the rules did not apply to it, and modified its behaviour (for example by implementing the controls on which Penson insisted) only in order that it might carry on doing what it had been doing before, but with better concealment.

143. There is little precedent about the level of penalty appropriate to conduct of this kind. Mr Otty referred us to some other decisions, but they related to different kinds of conduct and we did not find them of great help. Left to ourselves, we might well have concluded that £8 million was insufficient; but it is a substantial

sum and not so obviously too little that we feel we should take the step, which may operate as a disincentive to other, meritorious, applicants, of increasing it. We are not, however, persuaded that there is any basis on which a lesser penalty could properly be imposed. The penalty will therefore remain at £8 million.

5 **Conclusions**

144. For the reasons we have given in respect of each issue identified above, we have concluded:

(1) The Authority and this tribunal have jurisdiction over Swift Trade in the context of this reference;

10 (2) The conduct which we have described above falls within s 118 of FSMA, and specifically s 118(5);

(3) That it is not open to Swift Trade to argue that Merrill Lynch or Penson effected the relevant trades, but that they were effected by Swift Trade itself;

15 (4) The conduct was deliberate, manipulative market abuse in the form of "layering" and was not undertaken in accordance with recognised market practice;

(5) The conduct was not transparent but was designed to, and did, deceive other market users to their disadvantage and Swift Trade's benefit;

20 (6) Swift Trade has no defence, whether by virtue of s 123 of FSMA or otherwise;

(7) That the conduct was instigated, organised and managed by Swift Trade and not by the Dealers;

(8) The OSC Settlement Agreement is of no consequence in the context
25 of this reference; and

(9) The appropriate penalty is £8 million.

145. We so direct the Authority. Our decision is unanimous.

30 **Colin Bishopp**
Upper Tribunal Judge

Release date: 23 January 2013