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Dangerous Liaisons

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[I]t appears humiliating to the legislative authority of a state,
to whom we must naturally attribute the utmost wisdom,
to seek instruction from subjects (the philosophers) on principles of conduct [. . .].
It is nevertheless very advisable to do so....
Immanuel Kant "Perpetual Peace: A Philosophical Sketch"

Contents

List of Abbreviations

AMF	*Autorité des Marchés Financiers* (French Financial Markets Authority)
CJA	Criminal Justice Act 1993
CJEU	Court of Justice of the European Union (formerly European Court of Justice)
CESR	Committee of European Securities Regulators
Dz.U.	Polish official journal (*Dziennik Ustaw*)
ECHR	European Court of Human Rights
ECoHR	European Convention on Human Rights
ed.	Editor
eds.	Editors
e.g.	For example *(exempli gratia)*
etc.	And other similar things *(et cetera)*
ESMA	European Securities and Markets Authority
EUR	Euro
Fig.	Figure
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
GBP	Pound Sterling
i.e.	Namely *(id est)*
KNF	Polish Commission of the Financial Supervision (*Komisja Nadzoru Finansowego*)
MFC	French Monetary and Financial Code (*Code monétaire et financier*)
No.	Number
OLAF	European Anti-Fraud Office
p.	Page
PLN	Polish Zloty
PWC	PriceWaterhouseCoopers
SEC	American Securities and Exchange Commission
TEU	Treaty on European Union
TFEU	Treaty on Functioning of the European Union

TGI	Tribunal de grande instance
TGS	Texas Gulf Sulphur Co.
USD	United States Dollar
Vol.	Volume

Introduction

> Insider trading is one of the most controversial aspects of securities regulation, even among the law and economics community.
>
> Bainbridge, Stephen M., Insider Trading, p. 772

Insider dealing provokes many discussions. The common knowledge about this behaviour is that one may become rich thanks to a single transaction on a stock market. Such a perspective does not leave anyone indifferent; whether it be the expression of condemnation for such behaviour or an unspoken dream about becoming a well informed insider one day. Although many national systems prohibit insider dealing,[1] its character and potential wrongfulness are still discussed by economists, ethicists and lawyers. Definitely not all of them share the opinion, expressed by many national legislations, that insider dealing is unfair, wrongful, or harmful for the economy as well as for individual market players. Nonetheless, it may be observed that as the new insider dealing regulations were enacted, the prohibition has been enforced by application of increasingly severe penalties, including the use of criminal sanctions. A question may, however, be raised on whether criminal law is a right tool to deal with the issue.

With few exceptions, most of the legal works tackle the existing regulations without making a deeper analysis that would verify whether binding laws are compatible with the more basic principles underlying the whole legal systems. Such an approach is unavoidable in an everyday lawyer's practice, when the arising issues must be solved in a practical way and concrete answers given to a client. But sometimes, more fundamental questions have to be answered. Otherwise, if there is no concern for the principles of law, one risks that the binding laws may be enacted just in order to answer current political demands; with no respect for the underlying principles. It would lead to a separation between what is just and what can be found in legal acts. For that reason, a reference to more general concepts that emerge from

[1] Report of the Emerging Markets Committee of the International Organization of the Securities Commissions: Insider Trading – How Jurisdictions Regulate It, March 2003.

the philosophy of law is indispensable. They may determine the objectives that the legislature should pursue and, in consequence, be beneficial to the quality of the enacted laws.

The main objective of this work is to analyse the current shape of the insider dealing prohibition from the point of view of the principle-based application of criminal law. Thus, it confronts the existing insider dealing regulations with the findings of the economic and ethical researches as well as with the principles of criminal law and criminalisation. Moreover, it presents alternatives to criminal law that may be effectively applied in order to deal with this unwanted market phenomenon.

Therefore, the first part of Chapter 1 is dedicated to the development of the insider dealing regulation in Europe and in the United States of America. It describes the evolution of the prohibition and different motifs that justified the enactment of the new rules. The objective of this part is to underline the different approaches that may be taken in order to rationalise introduction of laws that combat insider dealing. In the part dedicated to the European Union, the work presents the binding acts that regulate this domain and the key notions that compose the insider dealing prohibition in the Member States of the European Union. Afterwards, it analyses the development of the insider dealing prohibition in the United States of America, the changes in the scope of the application and understanding of the notions during the second half of the twentieth century.

The second part of Chapter 1 focuses on the main arguments used in the discussion on the wrongfulness of insider dealing. Some of them are based on ethical premises and alleged immorality or unfairness of inside deals. They try to evaluate the behaviour and demonstrate what elements are inacceptable from the position based on morality. Nevertheless, the arguments of the opponents of the insider dealing regulation are also presented. For a group of ethicists, there is nothing ethically wrong with insider dealing and they do not accept the morality-based claims that support the prohibition. The second group of arguments refers to economic researches and analysis. Their presentation makes an attempt to confront different approaches without making reference to any qualitative notion but only concentrates on the phenomenon's influence on markets' structure and performance as seen by economists. Similarly as in the case of ethics-based considerations, the economists do not share a common reading of insider dealing. The opinions vary from definitive condemnation to support and even encouragement. In consequence, the main objective of this part of the Chapter is to demonstrate the differences among the specialists on the evaluation of this phenomenon and their propositions concerning the approach that should be taken by the legislature. It also aims at presentation of the "true face" of insider dealing. The justifications given for the introduction of new laws tend to give an unequivocally condemning vision of this behaviour. Meanwhile, the picture is more complicated than that and a presentation of different approaches may help the reader to establish his own opinion on the subject.

Chapter 2 tackles the practical issues arising from the transposition of the insider dealing prohibition into national legal systems. It describes the existing insider

dealing regimes in four Member States of the European Union, i.e. Luxembourg, Poland, France, and England and Wales (as parts of the United Kingdom). It attempts to demonstrate the disparities that still exist between different Member States in spite of the common basis, i.e. Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (hereinafter referred to as "the Market Abuse Directive" or "the Directive")[2] and other regulating acts. The presentation analyses the main notions of the Directive and how they were transposed into Member States' legal orders. Besides, it also refers to the practical concerns that may arise from application of the national laws and that emerged in administrative and judicial practice.

The objective of Chapter 3 is to analyse the basic concepts of criminal law theory. It examines the notion of criminal law as a separate branch of law and the tool of the legislature which is the most intrusive into human life. This analysis is necessary in order to distinguish it from the other branches of law which are based on different premises and have different objectives. Moreover, it presents the current trends that may be observed in the domain of criminal law and possible theories justifying application of criminal regulations. On this basis, Chapter 3 attempts to establish the principles that should be respected in order to use criminal law properly and criminalise behaviours only when it does not violate the basic rules that govern criminal law. Principles of criminalisation, originating from the works of the philosophers of the age of Enlightenment, are not very popular today. There are very few attempts to describe the principles that have to be respected in order to apply criminal law properly.[3] Nonetheless, their importance should be underlined. They create a basis that allows us to distinguish the behaviours that may and should be criminalised from the behaviours whose criminalisation would unnecessarily extend the scope of the application of the criminal law. As a result of this examination, the chapter presents a two-step procedure of criminalisation. Its objective is to promote such a use of criminal law that, instead of serving the short term political goals, would be focused on the protection of core human rights. Thus, it relies on an assumption that criminal law should be applied only when it is absolutely necessary. In the first step it verifies the wrongfulness of the given behaviour. Then, in the second step, it examines it with the help of the principles of criminalisation like legality, subsidiarity or the *in dubio pro libertate* principle.

Finally, the analysis of the notion of insider dealing and principles of proper criminalisation conducted in first three chapters creates a basis for an attempt to reconsider applicability of criminal law to deal with insider dealing and helps find the alternative solutions that may be used in order to regulate it (Chapter 4). Such alternatives include the application of administrative and civil laws. Moreover, one

[2] Published in OJ L 96, 12.4.2003, pp. 16–25, as amended.

[3] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, GARDOCKI, Lech, *Zagadnienia teorii kryminalizacji*, Warszawa, 1990.

may as well reconsider applying the "soft law" solutions like codes of good practices issued by the stock exchanges, which are applicable to all market participants who want to deal there. Finally, one should not forget about the educational campaigns that ought to be organised in order to increase the knowledge about the stock exchange market and its characteristics.

The main objective of this work is to combine the different concepts that are often analysed separately. Economic and ethical analyses tend to promote regulation or de-regulation of insider dealing without making reference to the basic concepts of criminal law. Meanwhile, presentations of principles of criminalisation do not usually make a direct reference to concrete acts of law. What is more, in the discussions, it is usually forgotten that criminal law is not the only tool at the legislature's disposal. The confrontation of all these elements of analysis, i.e. taking into account the binding regulations, the related opinions of economy and ethics specialists, as well as the principles of criminalisation may give a wider perspective on the issue of the proper enactment of the criminal law regulations. In consequence, it may present some directions regarding the properness of the prohibition of insider dealing based on criminal law.

It should be also underlined that the proposed two-step theory of criminalisation may be applied not only to insider dealing but to all behaviours that attract the attention of the legislature and may serve as a standard tool that helps take a final decision concerning the enactment of the new punitive rules.

Chapter 1
Insider Dealing Prohibition: Basic Construction, Economic and Ethical Perspectives

Insider dealing (or, according to the American terminology, insider trading) is the use of information that has not been made public by a person in possession of this information who on its basis acquires or disposes of the financial instruments.[1] Since the 1960s of the twentieth century, the opinion asserting the wrongfulness of this behaviour prevails and an increasing number of states have introduced insider dealing prohibition into their national legal systems.[2]

There can be distinguished two main systems that try to protect the markets against insider dealing. Each of them is based on different premises and objectives. The goal of the first part of this chapter is to present and analyse them. Firstly, the system of protection that has been introduced by the Market Abuse Directive[3] will be described. It is applied in all Member States of the European Union. Its main objective is to protect the markets and uninformed investors against the transactions conducted by persons who are in possession of information unavailable to other market players. Meanwhile, the insider dealing regulation in the United States of America is based on different principles. It concentrates on the fiduciary relationship between an insider and the company that "owns" the information. Moreover,

[1] E.g.: AYRES, Ian and BANKMAN, Joseph, *Substitutes for Insider Trading*, Stanford Law and Economics Olin Working Paper No. 214, 2001 Yale Law & Economics Research Paper No. 252. Available at SSRN: http://ssrn.com/abstract=265408 or doi:10.2139/ssrn.265408, p. 1, JEANDIDIER, Wilfrid, *Droit pénal des affaires*, Dalloz, 5th edition, 2003, p. 146ff, WANG, William K.S., *Stock Market Insider Trading: Victims, Violators and Remedies – Including an Analogy to Fraud in the Sale of a Used Car with a Generic Defect*, Villanova Law Review, 2000, Vol. 45, p. 27.

[2] The first anti-insider dealing decision was made in the United States of America in the administrative case *In re Cady, Roberts & Co.* (File No. 8–8925, Promulgated 8 November 1961), introduction of the insider dealing prohibition in France in 1967, for more details see respectively: Sect. A.II, Chap. 1 and Sect. B.I., Chap. 2.

[3] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), Published in OJ L 96, 12.4.2003, pp. 16–25, as amended.

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being an "owner" does not necessarily mean that the company is also the issuer of the financial instruments to which the information relates. Thus, a dealing insider is considered to violate his obligations towards the company he works for. These two approaches are at the origin of the differences in the scope of the prohibitions and the requirements that have to be fulfilled in order to comply with the rules regulating the prohibition. Both of them are important because they influence many important stock exchange markets and the behaviour of many market players.

It should be observed that, although many national legal systems forbid insider dealing and impose severe penalties on those who do not obey the prohibition, the specialists are not unanimous when it comes to demonstrate its wrongfulness, understood as being unfair or detrimental for the markets' development. The second part of this chapter attempts to present the possible ethical and economic arguments, both in favour and against regulation of insider dealing.

A Development of the Insider Dealing Regulation in the European Union and the United States of America

In the times of globalisation and unification of the global markets, the prohibition of insider dealing can be found practically on all stock exchange markets.[4] However, many important differences in the legal construction of the prohibition existing on different markets can be observed. Two big competing markets – European Union and the United States of America – are basing their regulations on different premises and, in consequence, their systems of protection differ importantly in some aspects. Although both big legal systems prohibit insider dealing, the justification of this prohibition and its objectives are different. Under the influence of the case-law,[5] the American interpretation of insider dealing evolved towards violation of fiduciary duties of the person who possesses inside information towards the company from which this information originates. Meanwhile, in the European Union, insider dealing is understood as a breach, by a person in possession of inside information who uses it, of a general duty of fairness towards the market and other uninformed market players.

In the following section both systems of protection will be presented in a more detailed way in order to determine more precisely the similarities and differences between them.

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[4] BENY, Laura Nyantung, *Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, Journal of Corporation Law; Winter 2007, Vol. 32 Issue 2, pp. 237–300, Report of the Emerging Markets Committee of the International Organization of the Securities Commissions: Insider Trading – How Jurisdictions Regulate It?, March 2003.

[5] Especially the *United States v. O'Hagan,* 521 U.S. 642 (1997), rev'g, 92 F.3d 612 (8th Cir. 1995), please see: Section "Misappropriation Theory" in this chapter.

I Market Abuse Directive

The objective of this division is to present the insider dealing prohibition according to the European Union law. First, it presents the evolution of the insider dealing regulation from its initial enactment in 1989. Then, the current shape of the prohibition is analysed. Special attention will be paid to those provisions of the European Union prohibition which relate to criminal law.

1 From No Regulation to Market Abuse Directive

The establishment of the internal market is one of the crucial objectives of the European Union.[6] It should not only facilitate the free movement of capital within the community but also encourage the external investors and make Europe (understood as a single market) more competitive on the global scale. The pan-European regulations of securities markets play an important role in the harmonisation of the financial markets of the Member States. This harmonisation has been made through numerous directives and regulations, such as the Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (the so called Markets in Financial Instruments Directive or MiFID),[7] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC,[8] or Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (so called Prospectus Directive).[9] As an element of this process, the directives regulating insider dealing were enacted.

a) First Years of the European Communities

In fact, the idea of unification of the insider dealing prohibition appeared even before the introduction of common rules governing other important aspects of the

[6] Article 2 of TEU which in substance refers to Article 2 of the Treaty establishing the European Community.

[7] OJ L 145, 30.4.2004, pp. 1–44, as amended.

[8] OJ L 390, 31.12.2004, pp. 38–57.

[9] OJ L 345, 31.12.2003, pp. 64–89.

stock exchange market was made.[10] It may be assumed that such trends were motivated by increased anti-insider dealing activity on the other side of the Atlantic Ocean.[11] The first suggestion to standardise insider dealing within the European law appeared as early as 1966 in the so-called Segré Report.[12] The proposition of the Segré Report was justified by the need to facilitate the movement of and dealing in financial instruments. However, the authors of the Segré Report did not insist on the prohibition of this kind of conduct but only noticed the possible problems arising from the transactions conducted by the directors or executives in the securities of their own companies.[13] The risks presented by the group of experts had not provoked any further discussion within the European Community for the next 20 years. It was not until the 1980s of the twentieth century that the issue of insider dealing regulation reappeared at the European level.

b) First Insider Dealing Directive

The legislative fight against insider dealing on the European Community level began with the adoption of Council Directive (89/592/EEC) of 13 November 1989 coordinating regulations on insider dealing (hereinafter referred to as the "Insider Dealing Directive").[14] In its introduction, the Insider Dealing Directive justified the need for protection of the markets against insider dealing by the statement that such a conduct was "*likely to undermine [. . .] confidence [of investors] and [might] therefore prejudice the smooth operation of the market*".[15] It should be noted that both reasons were presented as mere possibilities (through conditional forms like "likely") and no further justification was offered. At the moment of its enactment, most of the Member States had no insider dealing regulations.[16] It was a perfectly legal behaviour. In consequence, the main objective

[10] Such as e.g. a uniform prospectus that was introduced by the above-mentioned so-called Prospectus Directive 2003/71/EC in 2003.

[11] An administrative case, *In re Cady, Roberts & Co*. (File No. 8–8925, Promulgated 8 November 1961) taken by the American Securities and Exchange Commission begun the series of insider dealing cases in the United States of America, see Sect. A.II. in this chapter.

[12] *The Development of a European Capital Market,* Report of a Group of experts appointed by the EEC Commission, Brussels 1966 – available at http://ec.europa.eu/economy_finance/emu_history/documentation/chapter1/19661130en382develeurocapitm_a.pdf (last visited on 19 January 2010), MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 931.

[13] *The Development of a European Capital Market,* Report of a Group of experts appointed by the EEC Commission, p. 31.

[14] OJ L 334, 18.11.1989, pp. 30–32.

[15] Insider Dealing Directive, recital 6.

[16] CONAC, Pierre-Henri, *La Cour de justice facilite la répression des opérations d'initiés en établissant une présomption réfragable d'utilisation indue de l'information privilégiée*, Revue des sociétés, Juillet-Août 2010, p. 329.

of the Insider Dealing Directive was to introduce common insider dealing prohibition in all of them.

The regulation of insider dealing, according to the Insider Dealing Directive, meant the prohibition of taking advantage by a person in possession of inside information who, with full knowledge of facts, would acquire or dispose of transferable securities of the issuer or the issuers to which that information related.[17] Inside information was defined as information of a precise nature which had not been made public that related to issuer(s) of transferable securities or to one or several transferable securities and which, in case of its publication, would be likely to have a significant effect on the price of the transferable security or securities in question.[18] The prohibition was applied to insiders, i.e. persons, who possess inside information by virtue of their membership of the administrative, management or supervisory bodies of the issuer, of their holding in the capital of the issuer, or have access to such information by virtue of the exercise of their employment, profession or duties.[19] Moreover, the prohibition of insider dealing was also applied to any other person possessing with full knowledge of facts inside information while the direct or indirect source of this information could not be other than an insider as defined above.[20] Besides, in relation to insiders, the Insider Dealing Directive imposed prohibition of disclosing inside information to others, uninformed ones, as well as making recommendation on its basis.[21] Introduction of this prohibition in relation to the persons who acquired inside information from insiders was not mandatory and depended on the will of the Member States.[22] Thus, the authors of this directive allowed for certain disparities between the national regulations.

The Insider Dealing Directive did not specify what kind of sanctions should be applied for infringement of the prohibition. However, taking into consideration the European Community powers, it meant administrative sanctions. Moreover, in order to improve its enforcement, it required an appointment of an administrative authority that would be responsible for proper fulfilment of its provisions.[23] Besides, it underlined that the applied sanctions should be sufficient to promote compliance with the measures imposed by the Insider Dealing Directive.[24] The scope of the prohibition was determined as a minimal standard and all Member States were free to adopt more stringent provisions than those introduced by the Insider Dealing Directive as well as additional ones.[25] That meant that this directive

[17] Insider Dealing Directive, Article 2.1.
[18] Insider Dealing Directive Article 1.1.
[19] Insider Dealing Directive, Article 2.1.
[20] Insider Dealing Directive, Article 4.
[21] Insider Dealing Directive, Article 3.
[22] Insider Dealing Directive, Article 6.
[23] Insider Dealing Directive, Article 8.1.
[24] Insider Dealing Directive, Article 13.
[25] Insider Dealing Directive, Article 6.

created only a minimal base for insider dealing prohibition. The Member States could decide on the introduction of a more extended scope of the prohibition.

The Insider Dealing Directive created a legislative basis for adoption of a more detailed and more elaborated Market Abuse Directive.

c) Market Abuse Directive

Fourteen years after the enactment of the Insider Dealing Directive, it was replaced by a new one: the Market Abuse Directive. Compared to the Insider Dealing Directive, the Market Abuse Directive has a much larger scope of application. It regulates not only insider dealing but also selective disclosure[26] (only mentioned in the Insider Dealing Directive) and introduces as well a new prohibition of market manipulation.[27] Thus, the Market Abuse Directive aims at creation of a common system of control and sanctioning of all these actions.

The Directive's objectives refer to principle of subsidiarity and proportionality and the document states that prevention of insider dealing cannot be sufficiently achieved by the Member States acting independently. Therefore, the legislative intervention of the Community is needed.[28] Moreover, the Directive mentions Article 95 of the Treaty establishing the European Community,[29] which aims at approximation of the European common market, as its basis and as the justification of its enactment. Of course it might be discussed whether the Directive has achieved its goals. As it will be presented in this chapter, the provisions of the Market Abuse Directive have left some place for disparities between Member States.

It should be noted that the Market Abuse Directive was the first directive that has been introduced on the basis of a newly adopted Lamfalussy process[30] which remarkably influenced the way of introduction of new provisions of law.[31] The model is based on four levels of legislative acts undertaken in order to introduce a given European regulatory act towards national legislative systems. Each level has different functions and objectives. Together, they all aim at a transparent and

[26] Insider Dealing Directive, Article 7.

[27] MOALEM, David, HANSEN, Jesper Lau, *Insider Dealing and Parity of Information – Is Georgakis Still Valid?,* European Business Law Review, 2008, Vol. 19, issue 5, p. 959; the last of the three aspects of market abuse, i.e. selective disclosure is also regulated by Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, 31.12.2004, pp. 38–57).

[28] Market Abuse Directive, recital 41.

[29] Currently TFEU, Article 114.

[30] JANIN, Stéphan, *La première transposition d'une directive Lamfalussy*, Revue du marché commun et de l'Union Européenne, 2005, No. 485, pp. 86–88.

[31] PRÜM, André, *Le processus Lamfalussy sous examen,* Revue de Droit Bancaire et Financier, January–February 2008, pp. 1–2.

efficient creation of regulatory tools and more integrated European market.[32] Level 1 consists of framework principles that should be decided by normal European Union legislative procedures. Level 2 contains more detailed technical measures that precise the notions coined in the Level 1 acts. Level 3 tools should strengthen the cooperation between the regulators in order to improve implementation. Finally, Level 4 reflects the task of the Member States that should act as guardians of the European law on the national level. In practice, it means proper implementation of the European law into national legal systems.[33]

According to rules introduced in such a way, the Market Abuse Directive is the Level 1, i.e. the most basic, instrument. It is dedicated to creation of the broad general framework principles regulating the behaviours that impair the proper functioning of the financial markets. The introduction of the technical implementing measures was made through Level 2 directives and regulations,[34] namely: Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC as regards exemptions for buy-back programmes and stabilisation of financial instruments,[35] Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC as regards the definition and public disclosure of inside information and the definition of market manipulation,[36] Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest,[37] Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of the lists of insiders, the notification of managers' transactions and the notification of suspicious transactions.[38] The objective of the enactment of the above-mentioned documents was to clarify the concepts presented in the Market Abuse Directive and to facilitate its transposition into national legal systems.

Two subsequent levels of the Lamfalussy approach are dedicated to cooperation and enforcement.[39] Level 3 is based on the sets of guidance issued by the Committee of European Securities Regulators (hereinafter referred to as the "CESR"), the predecessor of the newly created European Securities and Markets Authority

[32] HOFMANN, Herwig C.H., TÜRK, Alexander H., *Policy implementation* in: HOFMANN, Herwig C.H., TÜRK, Alexander H. (eds.), EU Administrative Governance, Cheltenham : E. Elgar, 2006, p. 85.

[33] Final Report of the Committee of Wise Men on the Regulation of European Securities Market (the Lamfalussy Report), Brussels, 2001.

[34] Market Abuse Directive, recital 4.

[35] Published in OJ L 336, 23.12.2003, pp. 33–38.

[36] Published in OJ L 339, 24.12.2003, pp. 70–72.

[37] Published in OJ L 339, 24.12.2003, pp. 73–77.

[38] Published in OJ L 162, 30.4.2004, pp. 70–75.

[39] Market Abuse Directive, recital 4.

(hereinafter referred to as the "ESMA").[40] So far there were three sets of guidance published in May 2005, July 2007 and May 2009.[41] The possible problem that may arise from the guidance issued by the CESR is their non-binding character.[42] Therefore, even if some unclear statements can be found in the both Levels 1 and 2 acts, the explication or examples given in the CESR guidance are not supported by the authority of the legislative acts. In consequence, their application in practice by private parties may be on the long term misleading, because national authorities may apply CESR indication on a voluntary basis and are not forced to share the opinion of CESR on a given issue.[43] Finally, Level 4 is created by the national regulations aiming at transposition of the Market Abuse Directive and Level 2 act in the Member States' legal systems.

In practice, for an average market player, the most important provisions are the Level 4 national implementations of the Level 1 and 2 measures. They create rules governing the Member States' stock exchanges. Moreover, national legislatures, within the scope of the freedom given by the Level 1 and 2 instruments, may introduce different provisions. Consequently, existence of the differences between Member States is not excluded. Thus, the proper formulation of the Level 1 and 2 measures is of great importance in order to achieve the main goal and unify the European stock exchange markets.

2 Insider Dealing Prohibition According to the Market Abuse Directive

The notion of market abuse applies to different kinds of the behaviour that, in opinion of the authors of the Directive, jeopardise public confidence in markets and put at risk economic growth and wealth. The Market Abuse Directive states that market abuse consists of insider dealing and market manipulation.[44] In fact it regulates three kinds of behaviours: the two mentioned above but also selective disclosure.[45] Selective disclosure regulation, i.e. the obligation of a proper distribution of the inside information to the public, may be seen as a part of insider dealing.

[40] Regulation No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, pp. 84–119.

[41] Respectively: Market Abuse Directive Level 3 – first set of CESR guidance and information on the common operation of the Directive, CESR/04-505b, 11 May 2005, Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, Market Abuse Directive Level 3 – Third set of CESR guidance and information on the common operation of the Directive to the market, CESR/09-219, 15 May 2009.

[42] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 922.

[43] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 922.

[44] Market Abuse Directive, Recital 12.

[45] Market Abuse Directive, Article 6.

Inside deals may take place if only fragmentary information is presented to the public. However, many precise provisions ruling the way and timing applicable to the presentation information to the public enter into the scope of the selective disclosure regulation. They are only slightly related to insider dealing. Simply, insider dealing concerns the transactions made when information has not yet been made public and selective disclosure regulation deals with the proper way of presentation and distribution of information. For that reason the separation of these two notions is justified.

The distinction between insider dealing and market manipulation seems to be clear and should not provoke any doubts. Market manipulation is any action undertaken in order to give false or misleading signals as to the supply of, demand for or price of financial instruments as well as any action that tries to artificially fix the price of a given financial instrument on an artificial level that does not reflect its real value.[46] In such a way a "manipulator" cheats other market players and may profit from the transactions undertaken by misleading others. Thus, an element of deception is inevitably part of every attempt at market manipulation. This element does not exist in the case of insider dealing, because it is not oriented on giving any signals to others but on the insider's gain through a transaction.

As the objective of this work is to present insider dealing and the possibility of using criminal law to regulate it, the Market Abuse Directive shall be presented only to the extent that it relates to the subject.

a) Objectives of the Prohibition

Following the path indicated in the Insider Dealing Directive, the Market Abuse Directive imposes a strict prohibition of insider dealing. Moreover, the scope of the prohibition has been significantly extended and Member States have been encouraged to apply criminal law in order to punish violation of this rule.[47] When a given behaviour is being regulated and the governing law is very stringent, there must always be a sound and rational justification for such a legal intervention. Especially in a situation when the regulation prohibiting this behaviour not only inflicts administrative penalties but also promotes introduction of criminal prosecution.

The introductory recitals of the Market Abuse Directive present the opinion of its authors about the reasons justifying the prohibition of insider dealing and why an intervention on a European level was required to deal with this subject. According to them, the reasons for prohibition are the following:

[46] Market Abuse Directive, Article 1.2.

[47] Market Abuse Directive, Articles 2 and 14.

– market abuse harms the integrity of European financial markets and public confidence in securities and derivatives,[48] therefore its prohibition should boost the integrity of markets and enhance confidence of investors. The Directive underlines the need to combat with the same force both insider trading and market manipulation in the frame of the combined rules. Such an approach demonstrates the legislature's opinion about equal wrongfulness of insider dealing and market manipulation;
– insider dealing (as well as market manipulation) prevents full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets[49];
– prohibition is necessary in order to establish a level playing field in European financial markets.[50] This assumption is based on the concept of market egalitarianism, requiring that investors should have a relatively equal basis for their deals with equal possibilities to access information.[51]

All those arguments, although quite typical while justifying insider dealing prohibition, are based on little empirical support.[52] They are all founded on an unexpressed assumption that insider dealing is wrongful and should be forbidden and punished just because of its character. In spite of this simple diagnosis, the evaluation of the character of insider dealing is not so simple, as it will be in a more extended way presented in the second part of this chapter.

b) Constitutive Elements

Using very general terms, the notion of insider dealing may be explained as the use in securities transaction (action) of non-public information concerning the financial instruments (inside information) by a person who has an access to it because of his special position or who just accidently entered into possession of it (insider).[53] The same schema was used by the Insider Dealing Directive and then maintained by the Market Abuse Directive. It can be easily seen that this basic definition consists of quite imprecise elements that require further attention and analysis. Each of the three basic elements was defined and developed in the Market Abuse Directive as well as in the Level 2 implementing measures, and the Level 3 CESR guidance.

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[48] Market Abuse Directive, recitals 2 and 12.

[49] Market Abuse Directive, recital 15.

[50] Market Abuse Directive, recital 35.

[51] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 925.

[52] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 925.

[53] See, e.g. BAINBRIDGE, Stephen M., *The Law and Economics of Insider Dealing: A Comprehensive Primer*, Working Papers Series, February 2001, Available at SSRN: http://ssrn.com/abstract=261277.

In order to understand well the notion of insider dealing, a closer look should be taken at its constitutive elements. In the following subsections a more detailed analysis of the elements of the Market Abuse Directive definitions is made.

i. Inside Information

The definition of inside information in the Directive is composed of three separate definitions, two of them are determined on the basis of the kind of the financial instrument and one is distinguished on the basis of the professional character of the person who possesses it. Each of them requires separate analysis.

According to the first, most basic definition, inside information shall mean information:

- of a precise nature;
- which has not been made public;
- relating directly or indirectly to one or more issuers of financial instruments or to one or more financial instruments (other than derivatives on commodities);
- which, in case of being made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of the related derivative financial instruments.[54]

In relation to derivatives on commodities, the definition of information changes a little. It means information:

- of a precise nature;
- which has not been made public;
- relating directly or indirectly to one or more such derivatives;
- which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practices on those markets.[55]

The third variation of the definition of inside information is based on the professional abilities of the person who obtains it. Therefore it may relate to all kinds of financial instruments covered by the Market Abuse Directive, hence, also the derivatives on commodities. According to the third definition, for a person charged with the execution of orders concerning financial instruments, the scope of inside information applies also to information:

- conveyed by a client;
- related to the client's pending orders;
- of a precise nature;
- relating directly or indirectly to one or more issuers of financial instruments or to one or more financial instruments;

[54] Market Abuse Directive, Article 1.1.1.

[55] Market Abuse Directive, Article 1.1.2.

– which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative instruments.[56]

This definition, besides the additional requirement of a special source and destination, contains practically all elements of a basic insider trading definition. It does not include the notion of "not being made public", but the condition concerning the potential effect on the price seems to presuppose the non-public character of information. Nevertheless, it seems to be a legislature's omission which should not have taken place. One can argue that this omission is justified. Otherwise the distinction of a third kind of inside information would be irrational, because this kind of inside information would be anyway covered by the basic definition. However, as it was mentioned above, the context that determines the understanding of the last constitutive element for this kind of inside information seems to undermine this explanation.

The introduction of the third variation of the inside information definition might be also understood as an indication that making orders on specific transactions relating to financial instruments does not mean that this information has been made public and can be used by others, including market professionals. In such a situation, market professionals are still obliged to treat this information as inside information.

The last explanation for this third type of inside information is linked to the will of the legislature to combat front running,[57] i.e. trading by a stock broker in financial instruments when he had received an order that, according to his knowledge, shall influence the value of those instruments.[58] As it is presented in a more detailed way in the Level 3 – second set of CESR guidance, the third kind of inside information is directly deducted by a person receiving the order on the basis of three parameters: price, quantity and execution timing.[59] This interpretation, proposed by CESR, leads to recital 19 of the Market Abuse Directive, which underlines the need to tackle with the practice known as 'front running'. The interpretation given by the CESR guidance seems to reflect the will of the authors of the Directive.

As the notion of the "front running" was not mentioned or described in the definition of inside information, an opinion may be supported that the third kind of the definition aims at protection against a bigger number of behaviours than just "front running". A person whose professional formation or experience lets him/her draw more conclusions than an average person may not only "front run" but also use this information in another way. Probably the objective of introducing this

[56] Market Abuse Directive, Article 1.1.3.

[57] Market Abuse Directive, recital 19.

[58] PIECZYNSKA – CZERNY, Iwona, GRABOWSKI, Piotr K., *Dyrektywa Market Abuse w krajowym porządku prawnym zagadnienia wybranie*, KPWiG, 2006, p. 13.

[59] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 12.

definition was to protect the other market participants against the fact that a person professionally dealing with financial instruments may make more profit on the basis of the information that even if were public could be used only by the "most skilled". Permission for dealing or using this information in any other way might violate the level playing field idea. A professional stockbroker, on the basis of the orders given by a client, may evaluate the trading schemas and predict possibility of the variations in the value of the traded financial instrument. Therefore, any information he receives from a client should be considered to be inside information, even if this information is not inside information for any other market participant. Such an interpretation would lead to a quite paranoid situation. The same information about the orders presented to an average market player or any other person would not be considered to be inside information. Meanwhile, in relation to a person professionally dealing with financial instruments it becomes inside information. Aleksander Chłopecki noticed the absurdity of this situation.[60] In order to repair the logic of this definition and the whole prohibition of insider dealing on this basis he proposes to understand this kind of inside information in the following way: information related to the client's pending orders is so specific that it cannot be disclosed to anybody (even an average investor), in spite of the fact that only a qualified market professional would be able to use it.[61] However, a question may be raised on whether this interpretation does not go beyond the rules of legal interpretation. The wording of this provision does not refer to any other persons and does not impose such limitations.

The definition of inside information was in the main shape adopted on a basis of the Insider Dealing Directive wording. Changes concerned its extension on the derivatives on commodities. Moreover, a separate paragraph concerning market professionals was introduced. Nevertheless, the fact that the former definition has been used in the current Directive does not mean that it was sufficiently clear and unambiguous. Thus, the interpretation of the current definition also provokes some troubles in its analysis and, in consequence, may provoke some doubts in its application. Even if the above-mentioned problems concerning understanding of inside information definition in relation to market professional are put aside, its constitutive elements also provoke questions and disparities in their interpretation. Therefore, in order to facilitate its analysis, the notion of inside information shall be divided into smaller, more basic elements such as: information, precise nature, direct or indirect relation to the one or more issuers, non-public character and significant effect on prices.

[60] CHŁOPECKI, Aleksander, *Informacja poufna w prawie papierów wartościowych*, Prawo prywatne czasy przemian Księga Pamiątkowa ku czci Profesora Stanisława Sołtysińskiego, Poznań 2004, p. 386.

[61] CHŁOPECKI, Aleksander, *Informacja poufna w prawie papierów wartościowych*, Prawo prywatne czasy przemian Księga Pamiątkowa ku czci Profesora Stanisława Sołtysińskiego, Poznań 2004, p. 386.

Information. For the authors of the Market Abuse Directive, the notion of "information" did not require additional explanation. Therefore, the Directive does not define it any further. According to the rules of the legal interpretation, when a legal act does not contain a legal definition of a given notion, it should be understood as it is used in everyday language.[62] Meanwhile, precise delimitation of the notion of information in everyday language is not always easy. Borders between information, a rumour or a possibility might be very often blurred. And the concept of precise character of information does not help a lot. Quite the contrary, as it will be presented below[63] the additional requirement of being precise does not increase the precision of the definition.

Solely an action taken on a basis of inside information is considered to violate insider dealing prohibition and is, in consequence, prohibited. Therefore, the notion of information requires special attention. In order to better understand it, a reference to its everyday use should be made. According to the Longman Dictionary of Contemporary English "information" means *"facts or details that tell you something about a situation, person, event etc."*[64] Thus, information cannot be just somebody's guessing or supposition. It must relate to some facts, i.e. *"piece of information that is known to be true"*[65] or to precise elements of such fact, i.e. its details.

It might be assumed that through the introduction of such a definition of inside information in the Market Abuse Directive, the European legislature wanted to leave some space for interpretation of the notion of information to the national courts. Otherwise, there should be a precise definition of this element.[66] However, it may be in some cases very difficult to distinguish whether somebody entered into possession of information, a rumour or a prediction.[67] Moreover, in some situations, e.g. when information is accidently overheard or acquired by chance, someone may possess information, but be wrongly convinced that it is just a rumour or a speculation. A question might be asked on how such a situation should be evaluated by a competent authority – whether on a basis of an objective character of information or a subjective personal belief. These two possibilities may lead to engaging or not personal liability of a person who dealt while in possession of alleged information. Similarly, a reversed situation may be considered when one intentionally deals on a basis of information that he thinks to be inside information while it is only a someone else's supposition.

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[62] WRONKOWSKA, Sławomira, *Podstawowe pojęcia prawa i prawoznawstwa*, Poznań 2003, p. 80.

[63] Section "Precise Nature" below.

[64] *Longman Dictionary of Contemporary English*, Pearson Education 2009, p. 903.

[65] *Longman Dictionary of Contemporary English*, Pearson Education 2009, p. 607.

[66] WRONKOWSKA, Sławomira, *Podstawowe pojęcia prawa i prawoznawstwa*, Poznań 2003, p. 63.

[67] Similar concerns in: BRAUM, Stefan, *Europäische Strafgesetzlichkeit*, Frankfurt am Mainz, 2003, pp. 502–503.

Precise Nature. The requirement to be precise is the other important issue concerning the notion of inside information. It could be presumed that the notion of precise character was introduced in order to facilitate analysis of inside information. As it was shown above, interpretation of what constitutes information may provoke many difficulties. The European legislature wanted to specify its scope by adding an additional requirement. Only the application of precise information may inflict liability for insider dealing. Thus in order to pursuit someone for insider dealing it has to be proved not only that this person acted on a basis of information but also that this information was precise. Unfortunately, such definition is not specific enough to help in distinguishing precise information from another.[68] "Precise" means "*exact, clear and correct*".[69] But evidently it will be the role of a competent authority or a court to define the preciseness of information. And proving that information was not precise enough to constitute inside information will probably be also used as a defence of a suspected person.

The Level 2 Directive 2003/124/EC tries to describe more accurately the notion of "precise information". It states that "*information shall be deemed to be of a precise nature if it indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments*."[70] Such a definition shows that the objective of the European legislature was to include into the scope of the definition not only information based on the facts but also "reasonable expectations" about the possible future events. Nonetheless, the application of the notion of precise information not only to facts (which should constitute prerequisite for being called information) but also to reasonable expectations about the future provokes new problems. Determining whether expectations are reasonable and whether they may be called information at all extends importantly the scope of the notion of precise information.

The guideline given by the Level 3 Second set of CESR Guidance does not help to establish the exact limits of the definition, neither. The CESR underlines that *"precise nature of information is to be assessed on a case-by-case basis and depends on what the information is and the surrounding context."*[71] In order to help evaluate the information, the CESR recommends verifying whether a firm and objective evidence exists for this information which would distinguish it from rumours. But this indication concerns only the facts. In case of information that concerns *"what may reasonably be expected to come into existence"* the CESR's advice is vaguer and specifies only that the analysis should be based on the *ex ante*

[68] E.g. MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 953.

[69] *Longman Dictionary of Contemporary English*, Pearson Education 2009, p. 1361.

[70] Directive 2003/124/EC, Article 1.1.

[71] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 4.

information available at the time of using it.[72] Making such an analysis might be extremely difficult after the occurrence of the alleged inside deals. It requires distinguishing the facts and predictions available at the moment of transaction from their actual outcome. Besides, it should be noted that all elements of the inside information definition require *ex ante* approach during their analysis. Hence, the indication included in the CESR Guidance seems to be of little practical value.

Concerning Directly or Indirectly One or More Issuers of the Financial Instruments. The notion of a direct or indirect relation to one or more issuers is not extended in the Level 2 directives. Therefore, the analysis should be made on the basis of the Market Abuse Directive's brief formulation and on the second set of CESR guidance, which contains a non-exhaustive list of the examples of information concerning, directly or indirectly, the issuer.[73] According to this document, information directly concerning issuer relates to, generally, the composition of its governing bodies, economic performances, and changes in the ownership. Meanwhile, information which indirectly concerns the issuer has a more macroeconomic character. For example, it may refer to central bank decisions concerning interest rates, market authorities' decision regarding listed entities or rules concerning the markets, as well as data and statistics published by public institutions disseminating statistics or the coming publication of research, recommendation or suggestions concerning the value of listed companies.[74] While analysing this notion, it becomes obvious that an issuer very often does not have any knowledge about the content of information relating indirectly to him before its public disclosure by the entity that possesses it. That is the reason why the disclosure obligation imposed by the Market Abuse Directive concerns only information directly relating to the issuer.[75] However, in some cases even information relating directly to an issuer might be beyond the scope of his knowledge. That would be, for example, in the case of a takeover plan by another company. A company – the target of such a plan – would learn about its existence at the moment of the public announcement even if the direct relation of this information to the issuer is obvious.

As the scope of inside information relating directly to issuer seems to be quite natural and understandable, the scope of inside information relating indirectly to issuer proposed by the CESR in its guidance requires further attention. The CESR treats the governmental decisions concerning taxation, industry regulation as well as decisions concerning changes in the governance rules of market indices as inside

[72] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, pp. 4–5.

[73] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, pp. 6–9.

[74] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, pp. 7–8.

[75] Market Abuse Directive, Article 6.1.

information.[76] These are very important issues for market performance. However, their relation to a given issuer seems to be very indirect. In fact, such decisions influence the whole market. Therefore, a question may be asked on whether this kind of information should enter within the scope of the notion of inside information. An opinion might be supported that it should be rather regulated by internal rules on confidential information of governing bodies or issuing entities. Otherwise, the scope of the analysed notion is blurred by the extremely wide possible application.

Information That Has Not Been Made Public. The notion of publicity of information raises questions about the moment of time when information becomes public as well as the number of persons it should be disclosed to, in order to be called public. The issue should be analysed in relation to the third objective of the Market Abuse Directive, i.e. the fight against selective disclosure.[77] The Directive imposes an obligation on the issuers of financial instruments to inform the public as soon as possible about inside information that directly concerns them.[78] The delay of the public disclosure may be made when the disclosure would prejudice the legitimate interests of an issuer, only if such omission would not be likely to mislead the public and provided that the issuer would be able to ensure the confidentiality of that information.[79] Besides, in a case of disclosure of any inside information made by the issuer or a person acting on his behalf to any third party in the normal exercise of his employment, profession or duties, complete and effective disclosure of that information has to take place. The disclosure should be made simultaneously in case of an intentional disclosure or promptly in case of a non-intentional one. However, the last provision is not binding if the person receiving the information owes a duty of confidentiality, regardless of whether such duty is based on a law, on regulations, on articles of association or on a contract.[80] This exception allows for the existence of contracts that permit to transfer inside information, without public disclosure obligation, between a company and its subsidiaries, its parent company, or any other collaborating entity.[81]

The Second set of CESR guidance states that the way of disclosure should be specified by the national competent authorities.[82] In consequence, they should not only regulate how disclosure should be made but also under which circumstances

[76] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, pp. 8–9.

[77] Market Abuse Directive, recital 24.

[78] Market Abuse Directive, Article 6.1.

[79] Market Abuse Directive, Article 6.2.

[80] Market Abuse Directive, Article 6.3.

[81] The same opinion: CHŁOPECKI, Aleksander, *Informacja poufna w prawie papierów wartościowych*, Prawo prywatne czasy przemian Księga Pamiątkowa ku czci Profesora Stanisława Sołtysińskiego, Poznań 2004, p. 395.

[82] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 5.

information is considered to be made public. This approach may cause some problems for the companies listed in different Member States. Simply, distinct competent authorities may establish different disclosure mechanisms, and information publicly disclosed in one Member State may be still considered to be inside information in another.

Moreover, the CESR guidance also states that "*information can be publicly available even if it was not disclosed by the issuer in the specified manner*."[83] Such approach reduces the importance of the proper disclosure and opens a gate for many possible defences based on the public character of information. On the other hand, this "open gate" is understandable when taking into consideration the wide scope of the definition of inside information proposed by the CESR guidance. E.g. a question may be asked on whether publication of scientific data in a specialised scientific journal that may influence value of a given company because it refers to its main product could be considered as disclosure of inside information.

Another issue that should be noted in relation to the public disclosure of inside information arises from the egalitarian rationale for prohibition of insider dealing.[84] Although the Market Abuse Directive, unlike the Insider Dealing Directive, does not refer directly to egalitarian principle, it underlines the need of confidence for markets and a level playing field principle.[85] Therefore, if one agrees that an equal access to information is a prerequisite of a well functioning market, not only the moment of disclosure would be important, but also a sufficient period of time should elapse after public disclosure before insiders are allowed to deal. It would allow all market participants to learn about the information and limit the possibilities of insider to make profitable deals on a basis of freshly disclosed information. Neither the market Abuse Directive, nor the Level 2 and 3 measures deal with this matter and neither one proposes any rational solution for it. The sufficient gap of time between disclosure and being informed by the other market players evidently has to be regulated by the national competent authorities. In consequence, different rules may be applied and the same act may be qualified in some states as an inside deal while in others it may be perfectly legal.

Significant Effect on Prices. The Market Abuse Directive among the constitutive elements of inside information mentions its potential impact on the price of the related financial instrument.[86] Such formulation means that the value of inside information should be evaluated in a hypothetical way, basing on the data accessible *ex ante*. All possible scenarios have to be taken into account and the actual results should be considered only to the extent they were predicable. Thus, even if, after disclosure of information, it does not influence the price of a given financial instrument in the predicted strong way, one who used it may be accused and

[83] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 5.

[84] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 955.

[85] E.g. Market Abuse Directive, recital 43.

[86] Market Abuse Directive, Article 1.1.

prosecuted for a use of such information. According to some authors this unexpected weak influence on the market could be considered only as a circumstance limiting the responsibility.[87] However, application of such limitation is quite questionable. It limits the *ex ante* rule and introduces into analyses the premises of liability that have not been mentioned in the Market Abuse Directive.

Like many others elements of the inside information definition, the notion of potential effect of information on the prices of the financial instruments is in fact very imprecise. The sentencing body[88] should not base its decision on an actual result of the disclosure of information. It should try to analyse what would be the effect of the disclosure of the given information on the day when the presumed breach of an insider dealing regulation took place. Making such predictions might be very difficult and is always saddled with risk of error.

In order to specify the way information should be evaluated as having significant effect on prices, that additional definition was enacted. The Level 2 Directive 2003/124/EC specifies that *"…'information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments' shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions."*[89] Such an explanation is quite surprising. It refers to completely different criteria instead of developing the ones present in the Market Abuse Directive, i.e. influence on the prices. In fact, it introduces the new characteristics that should be taken into account during the analysis. The basic notion refers to changes in the value of a given financial instrument. Meanwhile, the Level 2 measure introduces a "reasonable investor test". The different financial instruments, the financial instruments of the same kind but relating to different issuers as well as these characterized by a different pattern of shareholders can have different changeability of value in time. Therefore, it is quite reasonable that no precise threshold was adopted in the Level 2 directive in order to evaluate the significance of the effect on prices. Consequently, Level 3 Second set of CESR guidance does not recommend introducing such thresholds to the national regulations.[90] Nonetheless, introducing a "reasonable investor test" into national systems may provoke divergences between national authorities applying the test to similar cases.[91] In order to help appraise the alleged breaches, the CESR presents some indications that should be analysed: the type of information and effect that had had similar information in the past, pre-existing

[87] CHŁOPECKI, Aleksander, *Informacja poufna w prawie papierów wartościowych*, Prawo prywatne czasy przemian Księga Pamiątkowa ku czci Profesora Stanisława Sołtysińskiego, Poznań 2004, p. 382.

[88] Of an administrative or a criminal character, both options are possible and, as presented below in Chap. 2, both options exist in the Member States.

[89] Directive 2003/124/EC, Article 1.2.

[90] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 6.

[91] Similarly: MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 957.

analyst research reports and opinions indicating the price-sensitiveness of information, the fact that the considered company had in the past considered similar information as inside information.[92] However, again, the list is not exhaustive and the analysis requires a case-by-case approach.

Furthermore, the level of "likeness" of a "significant effect on the prices" is quite imprecise. The CESR specifies that *"…on the one hand the mere possibility that a piece of information will have a significant price effect is not enough to trigger a disclosure requirement [therefore, in case of non-disclosure and use of that information there is not breach of the Market Abuse Directive's provisions – author's note] but, on the other hand, it is not necessary that there should be a degree of probability close to certainty."*[93] In practice, it shall be probably very difficult to distinguish between just possibility of having significant price effect and the level approaching to "a degree of probability close to certainty". This gap will be filled in by the national authorities taking actions with respect to insider dealing and, as in the others aspects, there is a considerable risk that their approaches may differ from one Member State to another.

ii. Insiders

The notion of insiders includes all persons who potentially may be engaged in insider dealing and, consequently, prosecuted for this behaviour. Similarly as with regard to other elements of the insider dealing definition, the Market Abuse Directive provides a very wide definition of insiders. First of all, the Directive underlines that the notion of insider should be applied to both natural and legal persons.[94] Then, Articles 2–4 of the Directive distinguish two groups of concerned persons: primary and secondary insiders.[95] Meanwhile, further analysis shows that in fact these groups are not homogeneous and within them different types of wrongdoers may be identified.

Primary Insiders. The notion of primary insiders is used in relation to persons that according to the Market Abuse Directive possess inside information by virtue of the fact that they:

- are members of the administrative, management or supervisory bodies of the issuer; or/and
- are holding in the capital of the issuer; or/and

[92] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 6.

[93] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 6.

[94] Market Abuse Directive, Article 1.6.

[95] However, the Directive does not use these labels.

– have access to the information through the exercise of their employment, profession or duties.[96]

In all above-mentioned cases, there is a contractual link between the issuer and an insider. Of course there still may be some doubt on whether it is possible to compare the position of the members of the management bodies and a holder of the shares. There is no threshold in the Market Abuse Directive that would differentiate the position of a holder of one share from a holder of 50% of shares in capital of the issuer, or from a member of the management body. Such an approach seems to be unjustified. A distinction should be made between small and big shareholders or members of the supervisory bodies. Their potential access to inside information is incomparable. Some authors consider that shareholding must be important enough that "by virtue" of it, a shareholder possesses inside information; therefore, small shareholders should not be affected by this provision.[97] Nonetheless, the absence of any indication in the Directive in this issue seems to exclude this possibility of the "mild" interpretation and imposes the strict application of definition of the insider to all investors.

The third group of primary insiders, i.e. those who have access to inside information through the exercise of their employment, etc., includes all those who work for the issuer and while exercising their professional duties learn about facts constituting inside information. In this category, one can also classify those who obtain insider information that lies beside the scope of their professional duties. It may happen, e.g. in the case of the employees of a different department in a company who learn about important changes in another unit of the company. Moreover, the information may be acquired accidentally while exercising professional duties which are only indirectly linked to the activity of the issuer to whom the information relates, e.g. when one works as a waiter who works in a restaurant where the members of issuer's management board meet for lunch. An opinion may be supported that the Market Abuse Directive requires the existence of a link between the occupation of a given person and the information. Such a statement refers to the obligation of creation by the issuer the "insider lists",[98] i.e. the lists of those persons working for the issuer, under a contract of employment or otherwise, who have access to inside information. The lists should be regularly updated and transmitted to the competent authority whenever the latter requests it. On the other hand, a view may be maintained that protection of confidence on the market requires that any, even the slightest professional link between the information and professional duties should suffice to be analysed under the provisions of the Directive.[99]

[96] Market Abuse Directive, Article 2.1 (a)–(c).

[97] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, p. 962.

[98] Market Abuse Directive, Article 6.3.

[99] MOLONEY, Niamh, *EC Securities Regulation*, 2nd edition, Oxford 2008, pp. 963–964 supports the narrower approach to the definition of a "real insider".

Moreover, the Market Abuse Directive also classifies as primary insiders those who possess inside information by virtue of their criminal activities.[100] This category was introduced to the draft of the directive after the attacks of 11 September 2001 on the World Trade Center.[101] Its objective was to fight not only those criminal activities that lead to acquisition of inside information (e.g. through theft of the documents) but also these, *"the preparation or execution of which could have a significant effect on the prices of one or more financial instruments or on the price formation in the regulated market as such"*.[102]

The objective of protection against insider trading in form of criminal activities can be understood. Nevertheless, the introduction of this category within the group of primary insiders seems not to be justified. There is no contractual link between criminals and an issuer (although such link may exist if a wrongdoer fulfils the other requirements of the analysed article of the Directive, like being in possession of a single share, but it is just a hypothetical, but still possible, example).

The comparative analysis of the Market Abuse Directive and the Insider Dealing Directive shows the will of the European legislature to extend importantly the scope of the insider dealing prohibition. The Insider Dealing Directive applied only to natural persons who acted in their names or for the account of a concerned legal person.[103] Meanwhile, the new Directive applies both to natural and legal persons. Moreover, it specifies that in relation to legal persons "*the prohibition laid down [. . .] shall also apply to the natural persons who take part in the decision to carry out the transaction for the account of the legal person concerned*".[104] Hence, in a case of alleged insider dealing exercised by a company (a legal person), responsibility of both the company and the persons who decided about transactions should be engaged. Moreover, the scope of these persons is also wide because the Directive refers to "tak[ing] part in the decision".[105] It can be understood that anyone who expressed his opinion about the transaction in some way participates in the final decision. This interpretation would extend the scope of application *ad absurdum*; nevertheless, the formulation of the article allows it.

Secondary Insiders. The notion of primary insider is not mentioned in the Market Abuse Directive. Nevertheless, it creates two groups of persons to which the prohibition applies. Thus, underlining the distinction between primary and secondary insiders seems to be justified. As it was shown above, the scope of application of the notion of primary insider exceeds the intuitive understanding of the word "insider". It relates to persons who have real influence on the performance of the issuer, such as managers or members of the governing bodies, but also to

[100] Market Abuse Directive, Article 2.1(d).

[101] FERRARINI, Guido A., *The European Market Abuse Directive*, Common Market Law Review 2004, Vol. 41, p. 722.

[102] Market Abuse Directive, recital 17.

[103] Insider Dealing Directive, Article 2.1–2.2.

[104] Market Abuse Directive, Article 2.2.

[105] Market Abuse Directive, Article 2.

those whose relation to the issuer is very weak (e.g. minority shareholders). More surprisingly, it also applies to persons such as a waiter overhearing conversation during an official dinner or criminals, who do not have any contractual link to the issuer.

Similarly wide, or even wider, is the second group, so-called "secondary insiders". A question might be even asked on whether it is still justified to call them insiders. The Market Abuse Directive describes them as "*any person [. . .] who possesses inside information while that person knows, or ought to have known, that it is inside information*".[106] As regards this category "the sky is the limit". In fact, everyone who knows something about the issuer or the circumstances that may possible influence the value of financial instruments should ask oneself whether this is inside information before he decides to acquire or dispose of financial instruments of this issuer. There is only one noticeable difference between secondary insiders and primary insiders. In case of the secondary insiders it is necessary to prove that they knew about the inside character of the information or to prove that there exists the circumstances under which these persons should have known about inside character of the given information. Meanwhile, such prerequisite does not exist in case of primary insiders. The Directive does not introduce any requirements regarding the state of the mind of the primary insider allegedly violating insider dealing prohibition.

In order to facilitate the analysis of this subjective notion of knowledge or "implied knowledge", the Market Abuse Directive states that "[*i*]*n this respect, the competent authorities should consider what a normal and reasonable person would know or should have known in the circumstances*."[107] Again, the task of interpretation of this very imprecise definition was left to the national competent authorities. The formulation of the Directive lets the notion of secondary insider apply to many persons. In fact, they should rather be called "outsiders" because there is no relation between them and the issuer of the financial instruments. The Directive confers the competence to decide what someone should know to the national authorities. The competent authorities shall decide on how experienced and educated in the stock exchange transactions "a normal and reasonable person" should be. Obviously, a more educated or experienced person should learn more easily that he or she is in possession of inside information than a stock exchange "amateur", even though the latter in other domains of life is "normal and reasonable". Perhaps, the competent authorities shall apply different criteria to evaluate the behaviour of different market players, depending on their experience.

The definition of the secondary insider introduced by the Market Abuse Directive differs importantly from the one proposed by the Insider Dealing Directive also in another aspect. The latter imposed prohibition of insider trading on any person *". . .who with full knowledge of the facts possesses inside information, the direct or*

[106] Market Abuse Directive, Article 4.

[107] Market Abuse Directive, recital 18.

indirect source of which could not be other person than a person referred to in Article 2 [i.e. a primary insider]".[108] It may be easily seen that in the new wording of the Directive these two important notions were removed: the need of a qualified source of information and the factor of "full knowledge of the facts".

The notion of qualified source of information was probably removed because of the practical impossibility to prove the way the information was obtained. Thus, now, the scope of responsibility for the breach of an anti-insider dealing regime is much wider. It includes the persons that received the information from primary insiders, other secondary insiders, but also cases when information was learnt accidently with no knowledge about its source (e.g. overheard conversation). The requirement of acting with the full knowledge of the facts is analysed in section "Acquisition and Disposal of Financial Instruments" below in relation to both secondary and primary insiders.

iii. Forbidden Practices

Analysis of the constitutive elements of the insider dealing inevitably must include the analysis of the types of behaviour that violate the prohibition. The Market Abuse Directive distinguishes two main kinds of forbidden practices: (1) acquisition and disposal of financial instruments and (2) disclosure of inside information or recommending acquiring or disposing of financial instruments on the basis of inside information.[109]

Acquisition and Disposal of Financial Instruments. First of all, it is prohibited to use inside information "*by acquiring or disposing of, or by trying to acquire or dispose of, for his [i.e. the insider] own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates*".[110] The scope and the wording of the prohibition have significantly changed compared to the formulation of the Insider Dealing Directive. The older version of the insider dealing prohibition defined the prohibited practice as "taking advantage of that information with full knowledge of the facts".[111] The difference between "use" from the Market Abuse Directive and "taking advantage" should not be underestimated. From the new definition any subjective element was removed and now there is no need to prove any intention of making a profit or avoiding losses. Such a change was introduced on the request of the European Parliament during the works on the new Directive.[112] The former notion presupposed that inside information was an element of the decisive process, one of the factors that played its role in deciding about trading in financial instruments. The results

[108] Insider Dealing Directive, Article 4.

[109] Market Abuse Directive, Articles 2 and 3.

[110] Market Abuse Directive, Article 2.1.

[111] Insider Dealing Directive, Article 2.1.

[112] Opinion of Advocate General Kokott delivered on 10 September 2009 in the CJEU case C-45/08, point 58.

achieved by a decision about dealing were not important. Simultaneously, "taking advantage" was much narrower and presupposed that inside information had been used in order to profit from the fact that other persons did not have this special knowledge and it was possible to make additional profit because of this informational disproportion. Thus, "taking advantage" can be seen as a qualified way of "use".

The interpretation of the notion of "use" was made by the advocate general in her opinion delivered in the CJEU case C-45/08. She underlined that "making use" of the information must be understood in a wider sense than what was proposed in the Insider Dealing Directive. However, in her opinion "*mere knowledge of inside information does not in itself imply use of that information*."[113] To illustrate this statement she gave an example of a person who undertakes some actions against future market trends that he can predict thanks to his knowledge of the inside information, e.g. when one disposes of financial instruments in spite of the fact that, to one's knowledge their value will increase in the future because he requires the proceeds of the sale immediately.[114] However, this interpretation reduces the difference before the new and old formulation of the prohibition. It requires that, in order to apply the prohibition, one should act logically and takes advantage of the possessed information. Meanwhile, the Directive does not contain any indication for such an approach. Nevertheless, the proposition given by the advocate general is the only solution that allows persons with access to inside information acquires in possession of inside information makes use of it while he deals.

That is why the Court of Justice of the European Union (hereinafter referred to as the CJEU) while analysing this notion observed that the change of formulation between the Insider Dealing Directive and the Market Abuse Directive had been made "*in order to remove any element of purpose or intention from the definition of insider dealing*."[115] The analysis of the provisions of the Directive was followed to the conclusion that the fact that "*a person [. . .] in possession of inside information, acquires or disposes of, or tries to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, the financial instruments to which that information relates implies that said person has 'used that information' within the meaning of that provision, but without prejudice to the rights of the defence and, in particular, to the right to be able to rebut that presumption. The question of whether that person has infringed the prohibition on insider dealing must be analysed in the light of the purpose of that directive, which is to protect the integrity of the financial markets and to enhance investor confidence, which is based, in particular, on the assurance that investors will be placed on an equal*

[113] Opinion of Advocate General Kokott delivered on 10 September 2009 in Case C-45/08, point 69.

[114] Opinion of Advocate General Kokott delivered on 10 September 2009 in Case C-45/08, points 67–69.

[115] CJEU, 23 December 2009, *Spector Photo Group and Van Raemdonck*, C-45/08, paragraph 34.

footing and protected from the misuse of inside information."[116] Such a judgment means that every deal made by an insider while in possession of inside information should be presumed to violate the prohibition imposed by the Directive. And the dealing person, in order to avoid punishment, should prove his innocence, i.e. prove that his actions were not "using" inside information but belonged to the planned before the learning about inside information strategy. In relation to insider dealing the CJEU replaced presumption of innocence by presumption of guilt. It considered this modification justified if only an accused party's rights of defence are guaranteed.[117] A question may be asked on whether it complies with an objective of strengthening in the European Union freedom, security and justice, especially if it is noticed that reinforcing of the procedural rights of the suspected or accused persons in criminal proceeding is one of the objectives of the European Union.[118]

It should be also underlined that the previous version of the Directive prohibited only acquiring and disposing of financial instruments. Therefore, the prohibition was applied only to accomplished actions. Meanwhile, the Market Abuse Directive extends the scope of the prohibition and its rules should be also applied to any attempt to make inside deals.

The other modification in the scope of the insider dealing prohibition when compared with the Insider Dealing Directive is the removal of the requirement that inside deals must be conducted "with full knowledge of the facts".[119] This prerequisite of the insider dealing liability applied before to both primary and secondary insiders. The opinion might be supported that in relation to a primary insider, such as a member of a supervisory body or even a shareholder (which is more dubious), this change does not play an important role. When he decides to trade, he already has information and full knowledge of the facts, or at least a possibility to learn about all circumstances, that let him evaluate it. However, as it was presented above,[120] the notion of primary insider includes also the persons who may get into possession of inside information without as wide knowledge as possessed by members of the decisive bodies of the issuer. Such persons on the basis of the Insider Dealing Directive could defend themselves with an argument of the fragmentary character of their knowledge. Meanwhile, the Market Abuse Directive excludes the possibility of such a defence. For a violation of the insider dealing prohibition, there is no need to prove any subjective element of consciousness that given information was inside information. The objective fact of possessing it is enough.

The similar change as in relation to primary insiders was introduced to secondary insiders. The Insider Dealing Directive stated that secondary insider had to

[116] CJEU, 23 December 2009, *Spector Photo Group and Van Raemdonck*, C-45/08, paragraph 62.

[117] CJEU, 23 December 2009, *Spector Photo Group and Van Raemdonck*, C-45/08, paragraph 44.

[118] As it is described in the Stockholm Programme – An Open and Secure Europe Serving and Protecting Citizens, published in OJ C 115, 4.5.2010, pp. 1–38, point 2.4.

[119] Insider Dealing Directive, Article 2.1.

[120] Section "Insiders", p. 20.

possess information with full knowledge of facts.[121] Such an obligation presumed that someone knew that the information that he possessed had not yet been made public and was, in consequence, inside information. Meanwhile, the current formulation of the definition of the secondary insiders includes not only the situation when someone knows about the non-public character of the information he possesses. In order to violate the insider dealing prohibition it is enough that one should have known about the non-public character of the information. That possibly means that if one has no certainty about the character of information and, being completely outside the structure of the issuer has no possibility to check it, he should refrain from dealing on its basis. And as was mentioned above, any possible actions of this person should be analysed by comparison to a benchmark of a "normal and reasonable person".[122]

Disclosure and Recommendation. Another behaviour forbidden by the Market Abuse Directive is the disclosure of inside information by an insider to any other person if it is not made in the normal course of the exercise of employment, profession or duties. Simultaneously, it is prohibited to make a recommendation or induct another person, on the basis of inside information, to acquire or dispose financial instruments to which that information relates.[123] These prohibitions apply not only to primary insiders but also to secondary insiders.[124] Thus, the application of this ban is extremely wide. It should be underlined that in the case of a secondary insider it applies towards any person in possession of inside information, whatever is its source and the scope of the knowledge of an insider. Therefore sharing with one's wife information overheard in a restaurant about good financial results of a given company violates the prohibition, even if one does not know that it is inside information. It would be enough that a competent authority would decide that one should have presumed that.

The objective of this prohibition is to limit the number of persons who come into possession of inside information before it would become widely known and not to let them make use of this information. According to the objectives of the Market Abuse Directive, sharing such knowledge would increase informational disparities between the market players and, in consequence, it would lead to unfair competition on the financial markets.

The second part of the prohibition, i.e. making recommendation and inducting another person to acquire or dispose of financial instruments to which inside information relates aims at the fight with the practice that would let to disclose the essentials of inside information (i.e. its potential influence on the market prices) without communicating the inside information itself.

[121] Insider dealing Directive, Article 4.

[122] Section "Secondary Insiders", p. 22.

[123] Market Abuse Directive, Article 3.

[124] Market Abuse Directive, Article 4 in relation to Article 3.

It should be noted that the prohibition and possible penalties are applicable to everyone who discloses or makes recommendation, and the issue of the personal gain of the revealing person has no importance. Moreover, the Market Abuse Directive does not require that the other person makes any transactions on a basis of acquired information or acquired recommendation. The simple transfer of knowledge suffices in order to violate the prohibition.

3 Territorial Application of the Market Abuse Directive

Another important issue is the application of the Market Abuse Directive to the inside deals that take place in one Member State but concern financial instruments listed on foreign stock exchanges. According to the Directive *"[. . .] each Member State should be competent to sanction actions carried out on its territory or abroad which concern underlying financial instruments admitted to trading on a regulated market situated or operating within its territory or for which a request for admission to trading on such a regulated market has been made. Each Member State should also be competent to sanction actions carried out on its territory which concern underlying financial instruments 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."*[125] Such approach may cause many problems in application of national relevant regulation. Due to the international character of the modern stock exchange markets, transactions rarely concern only one state. Each constitutive element of one inside deal, e.g. getting into possession of information, taking decision about the deal, making an order and finally performing the transaction, may take place in a different state, not necessarily belonging to the European Union. Therefore, there might be an important number of cases that would be sanctioned by different Member States, and the application of the different national systems of protection against insider dealing inevitably leads to disparities in imposed penalties. Besides, a behaviour that may constitute a breach of the insider dealing prohibition in one Member State, may be perfectly legal in another (for example, because of the different national rules concerning the proper or acceptable way of disclosure of inside information).

4 Exemptions

The analysis of the provisions of the Market Abuse Directive shows that introduced prohibitions have very wide scope and may be applied to the situations when in fact there is no insider but only a random passer-by and there is no dealing but only

[125] Market Abuse Directive, recital 35.

discussion with family members about overheard conversation.[126] Therefore, the Directive creates some rules in order to establish the area of allowed activities that do not violate the prohibition of insider dealing and let the persons who possess inside information to undertake some action on the stock exchange.

One part of the exemptions applies to the state's bodies and organs and arises from the political needs. The other exemptions presented in the Market Abuse Directive may be applied to any entity, regardless its character and ownership, and allow making use of inside information without breaching the insider dealing prohibition.

a) The State Bodies

First of all, the Market Abuse Directive shall not be applied to transactions carried out by Member States, the European System of Central Banks, a national central bank or by any other officially designated body or by any person acting on their behalf.[127] Additionally, Member States are entitled to extend this exemption to their federal states or similar local authority.[128] This exemption refers to the special entities due to their functions. It should be noted that the objective of such allowed transactions must be the pursuit of monetary, exchange-rate or public debt-management policy and in case of the delegation to federated states and local authorities – the management of their public debt.[129] In spite of the good intentions of the authors of the Market Abuse Directive, who probably wanted to allow the state-controlled entities conduct efficient budgetary politics, the solution accepted by the Directive may surprise. Supposing that insider dealing, as presented in the objectives of the Market Abuse Directive, is wrongful, impairs competition and discourages small investors from engaging into financial instruments markets,[130] the permission for a big market participant, supported by the state's authority, to use inside information cannot be justified. The unfair behaviour is still unfair even if it is adopted by a governmental institution and aims at the objectives that are beneficial for the budget.

b) Take-Over Bids

In relation to all market players, the insider dealing prohibition does not apply to the public take-over bid for the purpose of gaining control of that company or

[126] Both these situations violate the prohibition introduced by Article 3 and Article 4 of the Market Abuse Directive.

[127] Market Abuse Directive, Article 7.

[128] Market Abuse Directive, Article 7.

[129] Market Abuse Directive, Article 7.

[130] Market Abuse Directive, recital 43.

proposing a merger with that company.[131] Obviously, such decision is taken on the basis of the detailed analysis and due diligence conducted in the company being object of the take-over or merger. After those procedures, a potential co-contractor has much more detailed knowledge about the company than an average market participant. In such case, if taking decision on this basis was sanctioned as an act of insider dealing, no similar decision could be made. For that reason, permission to act on its basis is the only possible solution.

c) Realisation of Orders

The next exemption is defined in the Market Abuse Directive as follows: "*Since the acquisition or disposal of financial instruments necessarily involves a prior decision to acquire or dispose taken by the person who undertakes one or other of these operations, the carrying out of this acquisition or disposal should not be deemed in itself to constitute the use of inside information.*"[132] The goal of this provision is to demonstrate that the person responsible for insider dealing is the one that takes decision about acquisition or disposal of financial instruments and not the one that in fact does it, e.g. stockbrokers. Even without this clarification, such approach would be the only one acceptable. Since the market transactions are made through the intermediary of stockbrokers and other market specialists, the latter cannot be considered to be responsible for the decisions of the person conveying orders.

d) Results of the Analysis

Another rule of interpretation that can be found in the Market Abuse Directive provides that results of research and estimates developed from publicly available data should not be treated as inside information.[133] In consequence, the transactions carried out on a basis of such research or estimates should not be considered as violating the insider dealing prohibition. This exemption in fact violates the egalitarian principle on which the market exchanges should be based. The egalitarian approach aims at the creation of the common level of knowledge of the market players. Meanwhile, gathering and processing of data may give an informational advantage to one of the market participants. Nevertheless, if such an exemption did not exist, it might discourage more active market players from undertaking ambitious researches. This in fact would be detrimental for the stock exchange.

Some authors underline that this exemption should not be applied to the research and estimates made for the internal use of an issuer on the basis of his order. In their

[131] Market Abuse Directive, recital 29.
[132] Market Abuse Directive, recital 30.
[133] Market Abuse Directive, recital 31.

opinion, such a research, before its disclosure, constitutes inside information.[134] This opinion, however, seems to be unfounded. Its acceptance would mean that the issuer cannot undertake its own research based on publicly available data or, that even if it undertakes such a research it cannot use it afterwards.

Meanwhile, it should be kept in mind that the level 3 Second set of CESR guidance on inside information enumerates as information relating indirectly to issuer the coming publication of research, recommendations or suggestions concerning the value of listed financial instruments.[135] This statement does not specify what the basis of this research or recommendation should be and, in consequence, it may apply also to publicly available data. This provision of the guidance seems to be in opposition to the provisions of the Market Abuse Directive, but reflects the difficulties related to the proper market analysis. These differences in the approach to the results of the researches and their qualification as inside information or not just demonstrate how difficult it is to draw the limits of the notion of inside information.

e) Buy-Back Programmes

The Directive, similarly as in case of the governmental authorities, in certain circumstances and for economic reasons allows for the conducting of a plan of stabilisation of financial instruments or trading in one's own shares in buy-back programmes.[136] The scope of the exemption is narrower than in case of the state-controlled entities. Nevertheless, without this exemption, such behaviour might be considered as constituting market abuse, i.e. insider dealing or market manipulation. The Market Abuse Directive does not specify the conditions in which the insider dealing prohibition does not apply. On the basis of its delegation, the rules under which the stabilisation of financial instruments or buy-back programmes may be made can be found in the Level 2 Commission Regulation 2273/2003.[137] According to it, the exemption applies to the buy-back programmes only when their sole purpose is to reduce the capital of an issuer (in value or in number of shares) or to meet obligations arising from debt financial instruments exchangeable into equity instruments or arising from employee share option programmes, alternatively other allocations of shares to employees of the issuer or an associate

[134] CHŁOPECKI, Aleksander, *Informacja poufna w prawie papierów wartościowych*, Prawo prywatne czasy przemian Księga Pamiątkowa ku czci Profesora Stanisława Sołtysińskiego, Poznań 2004, p. 384.

[135] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, 12 July 2007, p. 8.

[136] Market Abuse Directive, recital 33.

[137] Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments, OJ L 336, 23.12.2003, pp. 33–38.

company.[138] Both procedures, i.e. stabilisation and buy-back programmes must be conducted according to the conditions described in Regulation 2273/2003.

f) Disclosure to a Person Bound by an Obligation of Confidentiality

The last exemption provided by the Market Abuse Directive was already mentioned in the section describing the non-public character of inside information. If inside information is disclosed to any third party in the normal course of the exercise of the employment, profession or duties, the violation of insider dealing prohibition is avoided when this information is simultaneously or promptly disclosed to the public.[139] However, this obligation is not binding if the third party who learns the information owes a duty of confidentiality, regardless of whether such duty is based on a law, on regulations, on articles of association or on a contract.[140] Thus, creation of a solid legal basis allows disclosure of inside information to third parties without violation of insider dealing prohibition. Otherwise, the issuer could not, e.g. obtain a legal advice from an independent law practice if the issue related to inside information without a simultaneous disclosure of this information to the public. But this exemption may be also used in order to process inside information between the companies belonging to one group. Although it may be noted that as long as there is no dealing in financial instruments the use of this information is barely noticeable for the controlling authorities.

5 Sanctions

The introduction of common criminal provisions at the moment of the enactment of the Market Abuse Directive laid beyond the scope of the European Community powers.[141] That is a reason why the Directive, in order to sanction the violation of its provisions, provides the obligation for Member States to introduce to their national systems effective, proportionate and dissuasive administrative measures and sanctions. However, the Directive does not stop at this point. It contains also a very interesting statement that the obligation of introduction of administrative sanctions is "*without prejudice to the right of Member States to impose criminal sanctions*".[142] In this way an explicit approval and even a kind of recommendation is given for

[138] Commission Regulation 2273/2003, Article 3.

[139] Market Abuse Directive, Article 6.3.2.

[140] Market Abuse Directive, Article 6.3.2.

[141] JAEGER, Marc, *Les rapports entre le droit communautaire et le droit pénal : L'institution d'une communauté de droit*, Bulletin du Cercle François Laurent, Bulletin, 2004 No. 1, p. 39. The situation has changed after the replacement of the EC Treaty by the TFEU which, in Article 83, confers important powers in the domain of the criminal law to the European Union.

[142] Market Abuse Directive, Article 14.

introducing, independently, both systems of regulation of insider dealing, i.e. administrative and criminal. This system of double prosecution belongs to the current tendency of combining different branches of law in order to combat economic crimes. The Stockholm Programme, i.e. a European Union document that defines the guidelines for years 2010–2014 in the domain of justice and home affairs, goes even further and proposes increasing the capacity of financial investigations and combining "*all available instruments in fiscal, civil and criminal law*."[143] Evidently, in the opinion of the European legislature, insider dealing constitutes such a danger for the markets that all available tools should be used to combat it.

One can ask whether it is conform to the rule of law to introduce two different systems of responsibility to punish a single action. The second issue is whether application of criminal sanctions is justified in case of the insider dealing. These issues will be presented in Chapters 3 and 4 dedicated to the principles of criminalisation and their applicability to solve the issue of insider dealing.

At this stage, before the presentation of national regulations in the next chapter, there should be presented briefly the potential risks of application of both administrative and criminal regulations. It should be kept in mind that the Market Abuse Directive is applied within the whole European Union and that, in the era of globalisation, the probable number of cases of insider dealing that may be prosecuted and punished in more than one Member State will constitute an increasing percentage of all insider dealing cases.

Even in the simplest case of the insider dealing having place entirely in just one Member State, presence of double sanction system makes the whole procedure of investigation and punishment more complicated. An alleged act of dealing on the basis of inside information would be, in such case, investigated according to rules governing two different procedures. Moreover, the final result in the two independent proceedings might be also different. Criminal responsibility is based on the notion of guilt. Besides, in democratic systems, the criminal procedure is limited by principles that restrict the possibility to decide on the basis of assumptions. In the meantime, administrative procedure is not limited by such constraints. The proof of guilt is not required and the judge is not limited by the *in dubio pro reo* rule. As a result, two different judgments could be pronounced in the same circumstances for the same action violating insider dealing prohibition. Such situation would inevitably impair the respect for the sentencing bodies.

Moreover, a question should be asked on whether the same one act can be punished by the application of two different procedures. The classical approach to the *ne bis in idem* principle concerns only criminal procedures. Otherwise there is no "*bis*".[144] Of course, in the case of the violation of the insider dealing prohibition the double sanction would be imposed in two proceedings of different character and

[143] The Stockholm Programme – An Open and Secure Europe Serving and Protecting Citizens, published in OJ C 115, 4.5.2010, pp. 1–38, point 4.4.5.

[144] VERVAELE, John A.E., *The transnational ne bis in idem principle in the EU. Mutual recognition and equivalent protection of human rights*, Utrecht Law Review, 2005, Vol. 1, Issue 2, p. 100.

of different objective. The objective of the administrative proceeding is to restore order according to the binding legal rules. Meanwhile, the objective of the criminal proceedings, if the theory of just desert is accepted,[145] is to justly punish the author of the infringement. However, in both lawsuits' aim, the state powers are engaged and in both severe penalties might be imposed on a wrongdoer. It remains true that only in the criminal lawsuit the penalty of imprisonment can be applied. However, the administrative regulations contain many severe sanctions, such as high pecuniary penalties. It very often blurs the distinction between the outcomes of the criminal and administrative proceedings.[146] These similarities justify the statement that the occurrence of both administrative and criminal prosecutions and penalties could be considered as a violation of the *ne bis in idem* principle. Thus, a question might be asked on whether a justification can be found for a violation of one of the important principles of criminal law and whether existence of double system of punishment would not be more detrimental for the respect for the law than beneficial for punishment or a possible deterrence of the potential insiders.

The same issue of violation of the *ne bis in idem* principle emerges in the case of cross-border insider trading activities. Let us suppose a given violation of the prohibition could be prosecuted and punished in two Member States. Meanwhile, one of them may provide only administrative sanctions while the other one apply only criminal penalties. The fact that someone was already judged and sentenced in administrative proceeding does not prevent him from being accused and sentenced in another Member State in a criminal proceeding. The Market Abuse Directive provides some rules that aim at reducing such risk of a double jeopardy. Among them there is a rule that the competent authorities may refuse to act on a request for information from a competent authority from a different Member State where judicial proceedings have already been initiated in respect of the same actions and against the same persons before the authorities of the Member State addressed or where a final judgment has already been delivered in relation to such persons for the same actions.[147] However, this rule just makes the investigation conducted by a competent authority from the demanding Member State more difficult but does not stop it. Moreover, the rule may be applied only if in the addressed Member State judicial proceedings have taken place. It is not clear whether this should apply only to criminal prosecution. After all, in case of an administrative procedure, at least the first step of it, there is no judicial proceeding.

[145] For more details see Sect. B, Chap. 3.

[146] Especially given that, according to the ECHR case law, because of the nature of the infringements and the degree of severity of the administrative sanctions which may be imposed, they may be, for the purposes of the application of the ECHR, qualified as criminal sanctions (e.g. ECHR case law: *Öztürk v Germany*, judgment of 21 February 1984, Series A no. 73, § 53; and *Lutz v Germany*, judgment of 25 August 1987, Series A no. 123, § 54).

[147] Market Abuse Directive, Article 16.2.

6 The European Union's Competences in the Domain of Criminal Law

Although such topic does not enter into the scope of this work, while analysing the elements of the insider dealing prohibition in the Market Abuse Directive, it is impossible not to comment the issue of the European Union competences in the domain of criminal law.

As mentioned above, the Directive encourages Member States to introduce criminal sanctions for a given behaviour. At the moment of its enactment the European Community was not entitled to introduce criminal sanctions in the domain of the common market. Of course, one can point out that "encourage" does not mean "impose" and therefore even if the legislature does not have any competences in this domain it may express its will in a non-binding declaration. Such approach however should not be supported. It meant the introduction of the new powers of the Community made through the "soft" and non-binding provisions that become binding, because of the authority of the enacting body.

Since the enactment of the Market Abuse Directive an important change in the European law has been made. The hitherto binding treaties were replaced by the TFEU and TEU (commonly called Lisbon Treaty) that entered into force on 1 December 2009. According to the new provisions, if the approximation of criminal laws and regulations of the Member States proves essential to ensure the effective implementation of a European Union policy in an area which has been subject to harmonisation measures, directives may establish minimum rules with regard to the definition of criminal offences and sanctions in the area concerned.[148] This possibility is limited by the various procedural requirements.[149] Nonetheless it exists and extends importantly the scope of the potential power of the European legislature. Thus, it should be very attentively observed whether it is properly used while enacting new laws for the European Union, i.e. with all due respect for the objectives and principles of the criminal law and not just as a convenient tool.

Meanwhile, the recent activities of the European Union demonstrate that the new powers will be rather used in order to increase the penalties applied in Member States. The Communication from the Commission of 8 December 2010[150] states that the current wording of the Market Abuse Directive is insufficient. The comparison of criminal and administrative sanctions applied in different Member States[151]

[148] TFEU, Article 83.2.

[149] TFEU, Article 83.3.

[150] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Reinforcing sanctioning regimes in the financial services sector, of 8 December 2010, available at: http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/COM_2010_0716_en.pdf (last seen on 14 February 2011).

[151] *Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD)*, CESR/07-693, 17 October 2007, *Executive Summary to the Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD)*, CESR/08-099, February 2008.

showed that there are still important differences between the toughness and kinds of the penalties. Hence, the Commission envisages introducing into European law the minimal sanctions that should be applied in all Member States, including obligatory application of the criminal sanctions.[152] It would mean an important extension of the provisions of the Market Abuse Directive. A question might be asked on whether it will be a step in the good direction and if someone in the Commission analysed whether application of criminal law to financial sector is conform to the principles of criminal law.

II The American Regulation

The fight against insider dealing, or more generally against market abusing actions, had been launched in the United States of America long before it begun in Europe. Thus, in many points, the origins of the European regulations should be searched on the other side of the Atlantic Ocean. For that reason the presentation of the American solutions is necessary in order to have a clear picture of possible arguments used to justify the prohibition of insider dealing as well as in order to see the evolution of the prohibition during the last century. After analysis it will become clear that the European solution is similar to the one existing in the United States about 30 years ago. Now Europe and North America have systems of protection against insider dealing based on different premises and in result in many cases an action that would be considered to violate insider dealing prohibition in the European Union would not be forbidden in the United States.

1 Introduction of the Insider Dealing Prohibition

Before an introduction of any regulation aiming at the fight against insider dealing on the federal level in the United States of America, some cases were judged on the basis of the state laws. However, not all the judges agreed on the wrongfulness of insider dealing. While analysing the current prohibition it is interesting to read what a court said in 1933 about selling or buying of shares on the stock exchange by the members of governing bodies of a company:

> "*Purchases and sales of stock dealt in on the stock exchange are commonly impersonal affairs. An honest director would be in a difficult situation if he could neither buy nor sell on the stock exchange shares of stock in his corporation without first seeking out the other actual ultimate party to the transaction and disclosing to him everything which a court or jury might later find that he then knew affecting the real or speculative value of such shares.*

[152] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Reinforcing sanctioning regimes in the financial services sector, of 8 December 2010, p. 14.

Business of that nature is a matter to be governed by practical rules. Fiduciary obligations of directors ought not to be made so onerous that men of experience and ability will be deterred from accepting such office. Law in its sanctions is not coextensive with morality. It cannot undertake to put all parties to every contract on an equality as to knowledge, experience, skill and shrewdness. It cannot undertake to relieve against hard bargains made between competent parties without fraud".[153]

As it may be seen, common opinion on trades made by insiders has changed a lot since that time.

Today, the American anti-insider dealing regulations are the combination of the statutory law, case law and the regulating activity of the Security and Exchange Commission – the American equivalent of the competent authority (hereinafter referred to as the "SEC"). The first regulation that aimed at the restoration of the rules of the fair behaviour on the stock exchange was the Securities Exchange Act that was adopted already in 1934.[154] It was a part of a New Deal era securities laws. The enactment was an answer to the 1929 market crash and subsequent depression. Two basic purposes of introduction of the Act were the protection of the investors engaged in securities transactions and the maintenance of public confidence in the integrity of the securities markets.[155] Surprisingly, in spite of the many years that elapsed and changes in the economy and stock exchange markets that occurred, this regulation is still binding. It should be underlined that since the beginning, it has not mentioned the phrase "insider dealing" or, as it is usually called in the United States, "insider trading". The objective of this act was to protect the market players against different kinds of the unfair market practices. Therefore, the role of the SEC policy and of the case law was to determine the scope of the prohibition and to diagnose and to name the actions that were unacceptable on the market. As the market circumstances changed, in spite of the unchanged formulation of the Securities Exchange Act, during the last 50 years the interpretation of the notion of insider dealing has been changing importantly. And as it will be showed below, the current meaning differs importantly from the European understanding of the notion.

2 Evolution of the Prohibition of Insider Dealing

From the point of view of insider dealing prohibition, the most important provision of the Securities Exchange Act is the section 10(b). It states that:

[153] Case *Goodwin v. Aggassiz*, 186 N.E. 659, Mass. 1933, citation made after BAINBRIDGE, Stephen M., *The Law and Economics of Insider Trading: A Comprehensive Primer, February 2001, Available at SSRN: http://ssrn.com/abstract=261277 or doi:10.2139/ssrn.261277*, p. 8.

[154] The Securities Exchange Act, 1934.

[155] BAINBRIDGE, Stephen M., *The Law and Economics of Insider Trading: A Comprehensive Primer*, February 2001, Available at SSRN: http://ssrn.com/abstract=261277 or doi:10.2139/ssrn.261277, p. 9.

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— [. . .]
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

As it has been already said, the whole paragraph does not mention the words "insider" or "insider dealing". The intention of the legislative body was rather to enact a flexible rule and to entitle the SEC to combat the new market practices that were unknown at the moment of the creation of the act.[156] Moreover, it should be underlined that the Securities Exchange Act authorised the SEC to create rules and regulations in the public interest and for protection of investors.

It was not till 1942 that the SEC decided to promulgate a rule on the basis of the given powers. The rule 10b-5, since its enactment, has been the foundation of the insider dealing prohibition. It states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[157]

Like the basis of this rule, i.e. Section 10(b) of the Securities Exchange Act, the SEC rule 10b-5 initially was intended to fight against the fraud in face-to-face transactions.

The second provision important for insider dealing prohibition is Section 16 of the Securities Exchange Act, which requires that insider transactions should be reported to the SEC.

Moreover, Section 16(b) provides that:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving any such equity security within any period of less than six months, unless such security or

[156] BAINBRIDGE, Stephen M., *The Law and Economics of Insider Trading: A Comprehensive Primer*, February 2001, Available at SSRN: http://ssrn.com/abstract=261277 or doi:10.2139/ssrn.261277, p. 10.

[157] 17 CFR § 240.10b-5, accessible at http://www.law.uc.edu/CCL/34ActRls/rule10b-5.html (last visited on 17 May 2009).

> security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security or security-based swap agreement purchased or of not repurchasing the security or security-based swap agreement sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; [. . .]

These provisions should be applied to "[*e]very person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) [. . .], or who is a director or an officer of the issuer of such security*".[158]

What should be noted about Section 16(b) is that the prohibition of sale of purchased financial instruments within the period of 6 months applies to every person mentioned in Section 16(a) without actually verifying whether such person had or did not have access to any inside information. Instead, a presumption is created that such transaction is made on a basis of a wider knowledge that a co-contracting party possesses. The application of this rule is independent from the source of acquisition of the financial instruments, which means that even a person who inherited a 10% share in a company is obliged to keep these financial instruments for at least 6 months before selling them in order not to violate Rule 10b-5.

Enactment of the Securities Exchange Act and the SEC rules that are based on it enabled application of these provisions toward insider dealing. The further development of the American insider dealing prohibition was made before the courts and in proceedings conducted by the SEC.

The first time when Rule 10b-5 was applied to insider dealing was in 1961, in a SEC enforcement action *In re Cady, Robert & Co*.[159] In this case, the SEC relied on the assumption that an insider in possession of material non-public information must disclose such information before trading and, if such disclosure is impossible or improper, he must abstain from trading. It was beginning of the so called "disclose or abstain rule".[160] However, its application was limited just to a SEC ruling, i.e. to an administrative procedure. The first time the "disclose or abstain rule" has been officially applied in a court proceeding was in 1968 by the Second Circuit Court of Appeals in the case of *SEC v. Texas Gulf Sulphur Co*.[161] It became a classing insider dealing case that for many years determined the shape of the insider dealing prohibition.

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[158] Securities Exchange Act, Section 16(a)1.

[159] 40 S.E.C. 907 (1961).

[160] BAINBRIDGE, Stephen M., *The Law and Economics of Insider Trading: A Comprehensive Primer*, February 2001, Available at SSRN: http://ssrn.com/abstract=261277 or doi:10.2139/ssrn.261277, p. 12.

[161] *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

a) Texas Gulf Sulphur Co.

The circumstances of the case were as follows. The employees of Texas Gulf Sulphur Co. (hereinafter referred to as TGS) led by the Vice President of the company, during the geological surveys, found an evidence of the important ore deposit in the area near Ontario. The drilling tests were made in November 1963 and their visual results were so interesting that TGS decided to acquire the plots of land in the area. Moreover, in order to facilitate the transactions, TGS' president instructed the persons participating in the survey that the results must be kept confidential and undisclosed even to other directors and employees of TGS. In December 1963 the official results of the test confirmed the previous estimations. Till March 1964 the land acquisition programme had advanced to the point that TGS was able to resume drilling. Further tests matched the first ones. Meanwhile, the rumours about the important discovery appeared. On 11 April 1964, the "New York Times" and the "New York Herald Tribune" published unauthorised reports suggesting that TGS found a rich ore deposit. In answer, on 12 April an official statement by TGS was made, declaring that in fact there was some drills made, but still more drilling was required in order to evaluate the importance of the finding. The official disclosure of the real meaning of the finding was published on 16 April 1964.

During the time from November 1963 to April 1964, some of the TGS's employees having knowledge about the drilling bought shares or options on shares. Other well informed persons disclosed the information to the members of their families or accepted the options granted by the uninformed TGS's board of directors, without informing the directors about the discovery.

The value of the shares from November 1963 to March 1964 was increasing slowly from about USD 18 per share to USD 25 per share. The rumours about the discovery increased the value of a share to about USD 30 and after the official disclosure of information the value of a single share achieved in May 1964 the level of USD 58.

When the action against TGS was brought before the court, the final judgment confirmed the SEC's allegation. It acknowledged the obligation to disclose the inside information before trading on its basis, otherwise one must abstain from dealing. At the same time, the court recognised the right of TGS not to disclose the information about the ore strike discovery. Such behaviour allowed purchasing the plots of land for the best possible price. And this decision was good for the company's shareholders.[162] As the company had no duty to disclose the information and the decision was taken about keeping it confidential, "anyone in possession of material inside information", i.e. the insiders of TGS as well as the company, was obliged to remain silent and abstain from all deals. This application would be also probably applied to a landlord who sold his plot of land and knowing about some

[162] Although it may be argued that these transactions were unjust because the plots of land were acquired from the persons uninformed about their real value.

drilling works done in the area decided on this basis to buy shares of TGS.[163] By application of this rule of conduct, according to the court, "*all investors trading on impersonal exchanges have relatively equal access to material information*."[164]

Therefore, the general rule established by the court's judgment was that everyone who possesses inside information was obliged either to disclose this information before the transaction or abstain from the deal. If such person's fiduciary duties precluded the disclosure, there was no other solution than refraining from dealing.[165] Therefore, the fiduciary duties of employees were seen as important as the obligation to trade on the basis of egalitarian access to information.

Although it is beyond the scope of the discussion on insider dealing prohibition, it should be noted that nor the court, nor the commentaries to the TGS case analysed attentively the role of the official statement given by the company after appearance of the rumours in the business newspapers. In spite of the fact that the results of drilling from the beginning were very promising and even visual analysis of the samples were sufficient to make a decision about the acquisition the plots of land in the area, the official declaration made by the company's representatives only mentioned the necessity of further examination of the potential discovery. The Court of Appeals just cited the trial court stating that "[*w*]*hile, in retrospect, the press release may appear gloomy or incomplete, this does not make it misleading or deceptive on the basis of the facts then known*."[166] This is quite a striking approach. The role of the fair presentation of facts made by a company should not be underestimated. And the approach of the court that the statement was just incomplete seems to approve such practices by the companies. Meanwhile, such improper press release may be seen as a kind of market manipulation. It tries to influence artificially the price of the financial instruments. In the TGS case it maintained the initial value of the shares. Consequently, it was a potentially very harmful for the market players' behaviour to which the rules concerning the fraud or market manipulation, but not the provisions prohibiting insider dealing should be applied.

b) The *Chiarella* and *Dirks* Cases

At the beginning of the 1980s of the twentieth century two important insider dealing judgments of the Supreme Court of the United States modified the "abstain or disclose" rule applied in the TGS case.

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[163] BAINBRIDGE, Stephen M., *The Law and Economics of Insider Trading: A Comprehensive Primer*, February 2001, Available at SSRN: http://ssrn.com/abstract=261277 or doi:10.2139/ssrn.261277, p. 15.

[164] *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

[165] BAINBRIDGE, Stephen M., *An Overview of US Insider Trading Laws: Lessons for the EU?*, University of California, School of Law, Law and Economics Research Paper Series, Research Paper No. 05-5, p. 3.

[166] *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

First, in the *Chiarella* case, the Supreme Court had to decide about the scope of the liability of a person who was not a primary insider, i.e. who was not working for the issuer of the financial instruments that were an object of the alleged inside deals.[167] The circumstances were as follows. Vincent Chiarella was an employee of a company that published tender offer disclosure materials. In spite of the fact that during the preparation of documents the names of the companies involved in the procedure of takeover were encoded, Chiarella broke the codes and purchased the shares in the target company before the information about the tender offer had been disclosed. If the "abstain or disclose" rule acknowledged in the TGS case had been used, Chiarella, as a person who possessed inside information, would have been found guilty of insider dealing. But the Supreme Court stated that the obligation of disclosure of information applies only when it arises from a relationship of trust or confidence between the parties.[168] Therefore, such an obligation would exist in a case of the deals made by an insider who had special duties towards the shareholders, but not in a case of a person who accidentally entered into possession of information. Compared to the TGS case, the scope of the obligation to disclose inside information was limited to the situations where a person in possession of inside information was bound by a duty to disclose it. And, in the Supreme Court opinion, such duty emerged from the fiduciary relationship between the insider and the persons with whom he traded, i.e. potential shareholders.

It should be also noted that the American approach linked very early the obligations arising from the insider dealing prohibition with the obligation created by a contractual relationship between a company and its shareholders. This issue practically does not exist in the European approach towards insider dealing.

The judgment in the *Chiarella* case greatly limited the scope of the insider dealing prohibition set up in the TGS case. As the existence of a fiduciary duty was required in order to impose an obligation to disclose inside information, it seemed that the prohibition might be applied only to the primary insiders within the narrow meaning of the notion, i.e. persons working for the issuer of the financial instruments.[169] But this interpretation of insider dealing prohibition was soon revised by the Supreme Court.

The judgment that extended this restricted scope of understanding the prohibition was rendered 3 years after the *Chiarella* proceeding in the *Dirks v. S.E.C.* case.[170] The circumstances of this lawsuit, very interesting for the notion of insider dealing, were as follows. A securities analyst, Raymond Dirks, received some clues from a former officer of Equity Funding that the company was engaged in fraudulent corporate practices. The analyst started to investigate the issue and uncovered a

[167] *Chiarella v. United States,* 445 U.S. 222 (1980).

[168] *Chiarella v. United States*, 445 U.S. 222 (1980).

[169] BAINBRIDGE, Stephen M., *An Overview of US Insider Trading Laws: Lessons for the EU?*, University of California, School of Law, Law and Economics Research Paper Series, Research Paper No. 05-5, p. 3.

[170] 463 U.S. 646 (1983).

substantial fraud. Dirks presented the results of his analysis to the SEC and the "Wall Street Journal" but also discussed his findings with his clients. In consequence, some of his clients had sold their financial instruments linked to Equity Funding before the official disclosure of the fraud was made and avoided substantial loses. Because of that sharing the knowledge with clients, the SEC started an investigation of Dirks' role in the disclosure and found him guilty of presenting the allegations of fraud to his clients. Now, the court had to decide whether the Dirk's behaviour should be punished as an act of insider dealing. After the *Chiarella* case it was difficult to foresee what would be the court's verdict. Dirk was not linked in any way to Equity Fund; therefore there was no relationship of trust and confidence towards the other participants of this entity. Moreover, he only transmitted his knowledge to his clients, and that evidently entered into the scope of his duties as a market analyst. All the subsequent trades were made by those who in fact paid for receiving valuable information concerning the investment. Meanwhile, the Supreme Court concentrated on the source of the initial information that Dirks had obtained and noted the important role of the first allegation about a possible fraud that Dirks had received from the former officer of the company. According to the Court's judgment, when Dirks learnt about a possible fraud scheme in Equity Fund, his liability derived from the confidentiality obligations of the person who informed him. Thus, if a disclosing person, by revealing the information, violated his or her fiduciary duties and the recipient of the information knew about it or had a reason to know, he would be also liable for his actions undertook on the basis of this information. But the Supreme Court set an additional obligation in order to analyse the violation of the insider dealing prohibition. Apart from the examination of the fiduciary duties of the person who discloses information, one needs to analyse why he decided to break the prohibition. According to the court's opinion expressed in the Dirk case, the liability was engaged if the disclosure was made for a personal gain, whether pecuniary or not (e.g. gain of reputation). In the case of Dirks, the former officer of Equity Funding acted in order to make the fraud public and protect other people from the possible consequences of investing into the funding. He did not want to make any profit on the basis of this information. Therefore, in the court's ruling, Dirks, who had received information from such a source and whose responsibility derived from the responsibility of the person disclosing the information, did not violate the prohibition of insider dealing.

Both judgments, i.e. those rendered in the *Chiarella* and *Dirks* cases, importantly limited the scope of the insider dealing prohibition. They reduced the scope of its application to primary insiders and those who received the information while knowing that its "source" violated his fiduciary duties. Moreover, not always could disclosing inside information be prosecuted. If it was not made for personal gain, there was no justification for imposition of the penalties.

c) Misappropriation Theory

When the scope of insider dealing prohibition was importantly limited by the courts' interpretations given in the *Dirks* and *Chiarella* cases, the SEC propounded a new theory of insider dealing liability: "the misappropriation theory". This approach changed the way the behaviour should be examined in order to verify whether it violates insider dealing prohibition. The classical "disclose or abstain rule" was focused on the breach of the fiduciary duty owed to the investor with whom the transaction was made, i.e. an uninformed market player, or to the issuer of the financial instrument. Meanwhile, the misappropriation theory is concentrated on the violation of the fiduciary duty owed to the source of information.[171] This theory makes a reference to a basic legal doctrine oriented on conflict of interests between the company owners (in principle, shareholders) and directors and managers who control its performance. Arising from the trust law principles, fiduciary duties mean duty of loyalty and impose an obligation for the company's managers to put the interests of the company and shareholders over their own.[172]

In order to use this theory, one should analyse the source of the information and the kind of relation existing between the source of information and the person to whom it was disclosed. If such a person is bound by an obligation to keep the information confidential, the violation of this obligation would breach the insider dealing prohibition. Such an approach would involve, e.g. punishing Chiarella on the basis of the breach of fiduciary duties owed towards his employer, the publishing company. In such a way, the violation of the insider dealing prohibition is based not on protection of market participants but on a theft of information.[173] The new theory is concentrating on a possible value that information may possess. By creating strong protection enforcement, an "author" of information would be encouraged to create more valuable data without risking that someone else should use them. In consequence, the American insider dealing regulation became more similar to patent regulation.[174]

It was in the *United States v. O'Hagan*[175] case that the Supreme Courte changed the path marked up by the *Chiarella* case and accepted the SEC's theory of misappropriation. This judgment was passed in the following circumstances.

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[171] BAINBRIDGE, Stephen M., *The Iconic Insider Trading Cases*, 2005, UCLA School of Law, Law-Econ Research Paper No. 08-05. Available at SSRN: http://ssrn.com/abstract=1097744, pp. 7–8.

[172] BAUMS, Theodor, SCOTT, Kenneth E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, The American Journal of Comparative Law, Winter, 2005, Vol. 53, No. 1, p. 37.

[173] Similar conclusions in: BAINBRIDGE, Stephen M., *The Iconic Insider Trading Cases*, 2005, UCLA School of Law, Law-Econ Research Paper No. 08-05. Available at SSRN: http://ssrn.com/abstract=1097744, p. 13.

[174] BAINBRIDGE, Stephen M., *The Iconic Insider Trading Cases*, 2005, UCLA School of Law, Law-Econ Research Paper No. 08-05. Available at SSRN: http://ssrn.com/abstract=1097744, p. 16.

[175] 521 U.S. 642 (1997), rev'g, 92 F.3d 612 (8th Cir. 1995).

James O'Hagan was a partner in the Dorsey & Whitney law firm. In July 1988 the law firm was engaged by the Grand Metropolitan PLC in connection with the planned take-over of Pillsbury Company. James O'Hagan was not in the team of lawyers that were responsible for the Grand Metropolitan PLC project. However, he learned about the takeover plans and bought Pillsbury shares and options for them. After the announcement of the tender offer the value of the shares increased considerably and O'Hagan gained USD 4,300,000. A judicial action against him was taken and he was convicted on many charges. The most important of them was the violation of Section 10(b) of the Securities Exchange Act and the SEC's Rule 10b-5 consisting of the trading on misappropriated non-public information. On appeal the court reversed the conviction. Finally, the case was transmitted to the Supreme Court. The final judgment reversed the appeal judge opinion and confirmed application of the misappropriation theory. The Supreme Court agreed that O'Hagan had no disclosure obligation towards the persons he was dealing with, i.e. towards the other market participants who had no knowledge about the planned takeover of Pillsbury Company. However, he had a fiduciary obligation towards the source of the information. Thus, the Supreme Court stated that "*a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defraud[ed] the principal of the exclusive use of that information*."[176] In such way the protection of the "owner" or the source of the information became the main objective of the insider dealing regulation.

The *O'Hagan* case has provoked a vivid discussion between American law specialists.[177] Moreover, the opinion expressed by the Supreme Court raised new questions on the interpretation of insider dealing regulation. The insider dealing prohibition can now be applied only to the transactions or disclosures that were undertaken without consultation with the entity or person being an "owner" of the information that had provoked such actions. One of the appearing questions that arise from the lecture of the *O'Hagan* case, declaring that a transaction made on the basis of inside information is perfectly legal when it is conducted after informing the source of information, is whether such transaction would be legal if the source of information objected to the deal. And the answer would be probably

[176] 521 U.S. 642 (1997), rev'g, 92 F.3d 612 (8th Cir. 1995).

[177] See e.g. AYRES, Ian, CHOI, Stephen, *Internalizing Outsider Trading,* Michigan Law Review, November 2002, Vol. 101, No. 2, pp. 313–408, BRUDNEY, Victor, *O'Hagan's Problems,* The Supreme Court Review, 1997, Vol. 1997, pp. 249–269, KARMEL, Roberta S., *Outsider Trading on Confidential Information – A Breach in Search of a Duty*, Cardozo Law Review, 1998–1999, Vol. 20, p. 83ff, NAGY, Donna M., *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion,* Ohio State Law Journal, 1998, Vol. 59, 1223–1310, STRUDLER, Alan, ORTS, Eric W., *Moral Principles in the Law of Insider Trading*, Texas Law Review, 1999, Vol. 78, No. 2, pp. 375–438, SWANSON, Carol B., *Reinventing insider trading: The Supreme Court misappropriates the misappropriation theory,* Wake Forest Law Review, Winter 1997, Vol. 32 Issue 4, p. 1157ff.

affirmative.[178] Most importantly, an issue arises whether the insider dealing prohibition focused on a protection of the source of information matches the initial objectives of the protection of market investors and equal access to information.

3 The Modern Shape of the Prohibition

The American insider dealing regulations are characterised by the very imprecise formulation of the laws that govern it. This gap was fulfilled by the regulations issued by the SEC and, above all, by the case law. However, as it was shown, the scope of the prohibition changed a few times and will maybe evolve in the future. Nevertheless, it may be said that the current shape of the insider dealing prohibition differs importantly from the system existing in the European Union. It concentrates more on the possible losses that may suffer the company to which relates the inside information than on the protection of the market players against dealing with well-informed insiders.

a) Scope of the Prohibition

Beside the general rules governing the insider dealing prohibition that were presented in Sect. 2 above, there are some precise rules that apply to more specific issuers of the prohibition. For instance, the partial regulation of the disclosure of inside information but only within the scope of the tender offer can be found in the SEC's Rule 14e-3.[179] The character of this rule is similar to the European prohibition; however its scope is much more limited. It prohibits the primary insiders from divulging information about a tender offer and, simultaneously, it prohibits trading on a basis of such information acquired directly or indirectly from such an insider. There is no need to verify whether a fiduciary duty existed or was breached and whether a tipper used the information for personal gain.

Very interesting from a European perspective is the enactment by the SEC in 2000 of the Regulation FD (Fair Disclosure).[180] It is the result of the practice that was allowed by the Supreme Court in the *Dirks* case, where the scopes of the liability of a person that discloses information and of its acquirer were established.[181] Because the court's interpretation forbade only a disclosure that was made by an insider for a personal gain (regardless the character of this gain – pecuniary or not), there was still a possibility to transmit such information in the case when such disclosure would be beneficial for a company. The objective of the

[178] BAINBRIDGE, Stephen M., *The Iconic Insider Trading Cases*, 2005, UCLA School of Law, Law-Econ Research Paper No. 08-05. Available at SSRN: http://ssrn.com/abstract=1097744, p. 22.
[179] 45 Fr 60418, Sept. 12, 1980.
[180] 65 FR 51716, 51738 of 24 August 2000.
[181] *Dirks v. SEC* 463 U.S. 646 (1983), presented in point 2.b.

Regulation FD was to limit such selective disclosure. Its main rule provides that whenever an issuer, or a person acting in his name, discloses any inside information (i.e. material non-public information regarding that issuer or its securities) to securities market professionals, he is obliged to make public disclosure of this information simultaneously, in case of an intentional disclosure, or promptly, in case on a non-intentional one. The non-disclosure is possible only when the person to whom information is disclosed is bound by an obligation of confidence, no matter what is the source of this obligation. The Regulation FD is in fact very similar to the provisions of the Market Abuse Directive.[182] But it should be noted that the European Directive does not limit the scope of the person to whom information is disclosed and requires the full and public disclosure in any case of presentation of inside information to any other person, not only market professionals.

The use of information engages personal liability only if this information is material and non-public. The interpretation of materiality given by the Supreme Court requires the presence of a substantial probability that a reasonable investor would consider the non-disclosed fact important in deciding his transactions related to financial instruments.[183] The notion of "non-publicity" presupposes that as long as information is not disclosed, the persons being in possession of it cannot trade on its basis. It may apply to the primary insiders, i.e. members of the governing or controlling bodies of a company. But, likewise, the prohibition binds so-called "constructive insiders" i.e. persons who obtained information from the part of a company with an expectation, based on an actual relationship, that they would keep this information confidential.[184] These elements of the insider dealing definition are similar to the criteria applied in the Market Abuse Directive. However, it should be noted that there is no requirement of potential effect on price of the financial instrument. Similarly, in the United States of America the information does not have to be precise in order to be inside information. Thus, the American competent authority is not obliged to prove these two rather imprecise elements.

The issue of whether each trade made by an insider in possession of inside information violates the prohibition of insider dealing or whether the prohibition concerns only the cases when information was actually used provoked a dispute between the SEC and the courts. Finally, in order to end the discussion, the SEC adopted Rule 10b5-1[185] that announces the prohibition of deals made "on the basis of" inside information. The notion "on the basis of" should be understood that "the person making the purchase or sale was aware of the material non-public

[182] Market Abuse Directive, Article 6.3.

[183] *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

[184] BAINBRIDGE, Stephen M., *An Overview of US Insider Trading Laws: Lessons for the EU?*, January 2005, UCLA School of Law, Law-Econ Research Paper No. 05-5. Available at SSRN: http://ssrn.com/abstract=654703 or doi:10.2139/ssrn.654703, p. 7.

[185] 65 FR 51716, 51737 of 24 August 2000.

information when the person made the purchase or sale".[186] At the same time, the Rule provides also the possible defences for a person in possession of inside information. In order to prove the lawfulness of his actions, one can prove that the transaction were made on the basis of the pre-existing contract, plan or instructions and, thus, does not fall within the scope of the insider dealing prohibition.

b) Procedure and Penalties

Created in 1934 by the Securities Exchange Act,[187] the SEC is a federal agency whose main task is the fight against fraudulent actions on the stock exchange market, including insider dealing, in the United States.[188] In order to assure the enforcement of the binding laws, the SEC may undertake various actions that may be of civil, administrative or criminal character.

First of all, the SEC is entitled to conduct investigations that aim at verification whether the insider dealing prohibition was violated. If this is the case, the SEC decides what kind of enforcement action to take.

What should be underlined is that the American legal system differs importantly from the one existing in continental Europe. Thus, sometimes, the terminology used to describe the type of lawsuit may be misleading. Such issue exists in relation to the basic SEC's power to bring an inside dealer to the civil court. Within the civil procedure a court is entitled to impose an injunction,[189] the penalty amounting up to the four times of the profit gained: the restitution (disgorgement) of the profit realised and up to the three times value of the profit as a civil penalty on the basis of the Insider Trading Sanctions Act of 1984.[190] However, the court may also decide to imprison an individual for contempt.[191] Meanwhile, the European civil courts are not entitled to order damages that exceed the amount of suffered losses or to deprive someone of liberty.

Although there is an option for individuals to launch the civil private action against inside dealer such actions are very rare and supplementary to the SEC's enforcement.[192]

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[186] Rule 10b5-1 point (b).

[187] Section 4 of the Securities Exchange Act.

[188] http://www.sec.gov/about/whatwedo.shtml (last visited 8 March 2010).

[189] Section 21A of the Securities Exchange Act.

[190] BAINBRIDGE, Stephen M., *A Critique of the Insider Trading Sanctions Act of 1984*, Virginia Law Review, 1985, Vol. 71, p. 471.

[191] http://www.sec.gov/divisions/enforce/about.htm (last visited 9 March 2010).

[192] BAINBRIDGE, Stephen M., *An Overview of US Insider Trading Laws: Lessons for the EU?*, January 2005, UCLA School of Law, Law-Econ Research Paper No. 05-5. Available at SSRN: http://ssrn.com/abstract=654703 or doi:10.2139/ssrn.654703, p. 8.

As for the administrative sanctions, the SEC is entitled to issue administrative decisions itself or to bring the case before administrative court.[193] Within this kind of procedure it may impose so called "civil monetary penalties"[194] which in the European terminology would be called rather administrative penalties.

Moreover, although the SEC itself cannot impose criminal penalties, it may ask the Justice Department to initiate a criminal prosecution.[195] And when it finds it justified, it may also bring criminal cases to the criminal courts around the world.[196] Finally, even without the SEC's initiative, the Justice Department is entitled to initiate criminal prosecution independently on its own initiative.[197]

c) Conclusions

Two important stock exchange markets, the European and American ones, recognised the insider dealing as a threat to their smooth functioning. Thus, special regulations that aim at protection of the stock exchanges and uninformed investors were introduced in both markets.

The American regulation is much older than the European fight against insider dealing. Based on very general provisions of law it has been evolving during the last 50 years. Initially it was oriented on the equal access of all market participants to information. However, the current shape of the prohibition is more concentrated on the protection of the persons or entities that "produce" and therefore "own" valuable information. This change approached the insider dealing prohibition towards the patent regulation and concentrated on the fiduciary duties that one has towards the initial holder of information.

Meanwhile the European insider dealing laws, now governed by the Market Abuse Directive and other derived directives, concentrate on the creation of a level playing field for all investors. The objective of the prohibition is the creation of stock exchange markets where no one can use his superior knowledge regardless of its origins.

In spite of these disparities both legal orders use similar notions in order to describe the notion of inside information and its use. Naturally, there are some differences and some additional prerequisites of responsibility that occur only in one of them. But it may be observed that both legal systems are not free of

[193] http://www.sec.gov/divisions/enforce/about.htm (Last visited on 9 March 2010).

[194] http://www.sec.gov/about/whatwedo.shtml (Last visited on 9 March 2010).

[195] BAINBRIDGE, Stephen M., *An Overview of US Insider Trading Laws: Lessons for the EU?*, January 2005, UCLA School of Law, Law-Econ Research Paper No. 05-5. Available at SSRN: http://ssrn.com/abstract=654703 or doi:10.2139/ssrn.654703, p. 8.

[196] http://www.sec.gov/about/whatwedo.shtml (Last visited on 9 March 2010).

[197] BAINBRIDGE, Stephen M., *An Overview of US Insider Trading Laws: Lessons for the EU?*, January 2005, UCLA School of Law, Law-Econ Research Paper No. 05-5. Available at SSRN: http://ssrn.com/abstract=654703 or doi:10.2139/ssrn.654703, p. 8.

drawbacks. The general provisions of the regulations result in interpretation difficulties. In the United States of America it may be seen in different approaches to the prohibition applied by the courts in examined lawsuits. But, as it was shown, the European Market Abuse Directive and the accompanying acts also comprise many unclear definitions.

What should be noted is that in both legal systems there is a wide variety of possible sanctions that can be applied. The American authority, the SEC, may apply directly administrative sanctions, bring action to the civil court (which in fact, from the European point of view, can impose criminal penalties) and finally incite criminal prosecution of the actions. The European Market Abuse Directive imposes on the Member States the obligation to introduce administrative sanctions to be imposed on persons and entities violating the insider dealing prohibition and additionally encourages creation of the parallel criminal prosecution system. And, as it will be presented in Chapter 2, this possibility was widely accepted by the Member States. In that way both American and European methods of enforcement of the insider dealing prohibition are quite similar. In both situations an individual accused of using inside information faces substantial penalties and even a risk of imprisonment.

A question may be asked on whether these sanctions are well founded and insider dealing is so intrinsically wrongful that all possible tools of law enforcement should be applied in order to prosecute it. This issue will be presented in the next section.

B Discussion on Ethical and Economic Justification of Insider Dealing Prohibition

As it was presented above, the prohibition of insider dealing is well established in the European Union's and in the United States of America's legal systems. The existence of the insider dealing prohibition and expansion from administrative regulatory provisions towards criminal law seems to be unquestionable. Meanwhile, one may ask why insider dealing should be prohibited, what justifies creation of such a regulation and what is protected by these provisions. Especially, when criminal law, i.e. the strongest tool of the state power, is applied, the need of such a justification is essential.

The main arguments that are used in order to examine the objectives of the insider dealing prohibition may be divided in two groups: those based on ethical grounds and those based on economic premises. It should be underlined that within each group both arguments supporting and criticising the existence of the regulation of insider dealing can be found. Those supporting the regulation are in general terms mentioned in the recitals of the Market Abuse Directive. One can find among them fairness of the market and equality of information for all investors. However, there are authors who claim that insider dealing is wrongful neither from an ethical

point of view nor from an economic one. Moreover, some of them declare that it has a beneficial influence on the market. Thus, if these theses were found convincing, they should influence the legislatures and prevent the creation of the regulations prohibiting insider dealing. Some of the differences between the economists and ethicists during their discussions arise from the differences between the European and American understandings of insider dealing and the objectives of its prohibition. Nonetheless, as in the era of globalisation, the economic notions tend to common global understanding, all arguments should be analysed with an equal attention. In consequence, a brief overview of the most important statements is necessary in order to evaluate the need of regulation of insider dealing and the kind of sanctions that should be applied to it.

I Ethical Arguments

Law and ethics influenced each other since the very beginning of human history and the creation of the first legal systems. In the ancient times the rules of law were "given by gods". Therefore, there was no difference between them and the binding moral rules.[198] Nowadays, the situation has changed. There are many different ethical systems coexisting within the societies and their rules not always are the same as the rules of the binding legal provisions. Moreover, many legal rules are ethically neutral, e.g. those concerning the speed limit.

Ethicists try to find a distinction between the fair and unfair behaviours. In the case of insider dealing, they attempt to find an answer for the question on whether a situation in which one person is dealing while in possession of inside information creates an unfair advantage and can be seen as exploitation of an uninformed person.

1 Unfairness and Harmful Character

The most popular ethical argument against insider dealing is based on a presumption that it is simply unfair.[199] An insider allegedly acts unfairly when he acquires or disposes of financial instruments while in possession of inside information. This

[198] And at that time, creation of the criminal rules was much easier because no one had doubts about its justification. As Gustave RADBRUCH said: *"only as long as criminal justice was employed in the name of God or customary laws could we punish with a good conscience"* in: RADBRUCH, Gustaw, *Einführung in die Rechtswissenschaft*, Konrad Zweigert ed., 9th ed., 1958, p. 132, cited in: JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio),* Ohio State Journal of Criminal Law, 2005, Vol. 2, p. 522.

[199] SCHEPPELE, Kim Lane, *"It's Just Not Right": The Ethics of Insider Trading*, Law and Contemporary Problems, 1993, Vol. 56, No. 3, Modern Equity, pp. 123–173.

assumption arises from the fact that he deals with someone who does not have the same knowledge. However, this intuitive judgment requires further justification in order to become a basis for an intervention of the legislature (and, consequently, a prosecutor). If the presumption about unfairness of insider dealing is well grounded, an issue has to be analysed on who is harmed by such behaviour and what kind of rights are violated. Therefore it should be analysed whether it is fair to deal while one of the investors is better informed than another,[200] or whether insider dealing is unfair towards the employer of the dealing person, other persons in possession of financial instruments and other market players.

a) Advantage of Superior Knowledge

The main ethical objection to insider dealing is that an insider who deals in financial instruments takes advantage of his superior knowledge over other market participants. And that allegation is true. This is the essence of insider dealing that an insider makes a deal when he is in possession of information that others cannot use because they do not know about it. However, a question on whether fairness requires that the parties to each transaction possess the same knowledge may be asked.[201] A practical realisation of a postulate of equal knowledge seems to be unattainable. No one can be forced to learn all available data. And law should not promote the lack of interest and force a more active party to an agreement to limit his knowledge (if it were possible). Moreover, practically all professions that require some skills are based on superior knowledge of one party and a possibility to make use of it. No one blames a doctor for charging his patients for his advices based on his superior medical education. Similarly, there is no prosecution in a case when someone learns from his relatives that a given company is looking for a new employee and applies for this position, or when one learns from one's neighbour about a special discount offer starting the next day in a nearby shop and goes there in the morning to make a good deal.[202] All these situations do not seem to violate the ethical principles that are applied in any society. But if the similar situation concerns the financial instruments and knowledge about their future increase or

[200] LELAND, Hayne E., *Insider Trading: Should It Be Prohibited?,* The Journal of Political Economy, 1992, Vol. 100, No. 4, p. 860.

[201] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing*, Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 3.

[202] The last two examples given by: MCGEE, Robert W., *Applying Ethics to Insider Trading*, Journal of Business Ethics, 2008, No. 77, p. 206. Another interesting example is given by ENGELEN Peter-Jan and LIEDERKERKE Luc V., *The Ethics of Insider Trading Revisited*, Journal of Business Ethics, 2007, No. 74, p. 502: *"[I]t is standard practice in news reporting that a journalist who discovers some important news facts, does not share this information with his colleagues, but instead scoops the competition. Among journalists this is considered professional behavior and might even earn you a Pulitzer Prize."*

decrease of value, the laws let the prosecution launch a proceeding that may result in punishment of persons engaged in the transactions.

The discussion on the use of superior knowledge may be led on two distinct levels. First of all, it can be defended that parties to the agreement should possess the same knowledge about its object.[203] However, as it was shown on the examples above it is practically impossible and does not provoke any ethical doubts when the informational irregularity is applied to other domains of social behaviour.

Instead of an obligation to be equally informed, more justified seems to be a discussion on an equal access to information. For many opponents of insider dealing this is the crucial argument that justifies its prohibition.[204] They consider that insiders and other market participants dealing with them are in a completely different situation. Such approach is justified by the fact that an insider has an access to inside knowledge about company that his contractors do not possess. Moreover, they distinguish between the special knowledge of a doctor that can be potentially acquired by everyone who wants to study medicine and the knowledge of an insider who derives it from the fact of working for a given company. However, this objection does not take into account that in order to become an insider someone also had to make a choice to work for a given company and, as inside information usually can be acquired only on a high level in a corporate hierarchy, he had to present the sufficient qualification, experience or devotion to work in order to achieve such a position.

b) Harm

The next issue that should be analysed is who is harmed by insider dealing. In order to declare that insider dealing is wrongful, the harm should arise from deprivation of possibility to use inside information while making investment decisions.

Consequently, another question may be asked, namely who is victimised by insider dealing. Ethics does not require that in order to condemn a given behaviour there must be a victim. However, presence of an injured party increases the probability that the analysed act is judged as ethically wrongful. The issue of the victim from the point of view of principles of criminalisation is presented in Chapter 3. In this place it will be analysed in relation to ethics.

i. Market

Very often the notion of victim is applied to general notions like "market", "society". In case of these notions it is practically impossible to determine to

[203] LEVMORE, Saul, *Securities and Secrets: Insider Trading and the Law of Contracts*, Virginia Law Review, 1982, No. 68, pp. 117–160.

[204] SCHEPPELE, Kim Lane, *"It's Just Not Right": The Ethics of Insider Trading*, Law and Contemporary Problems, 1993, Vol. 56, No. 3, Modern Equity, p. 125.

what extent they are harmed and how this harm could be described. As these are very general ideas, the application of the notion of harm towards them is doubtful. One may try to explain the harmfulness of insider dealing by using an economic explanation about its influence on market performance. In consequence, if such a relation was proven and insider dealing impaired the proper functioning of the markets it could be claimed that insider dealing "harms" the market. But still the use of the notion of harm to the abstracts notions is questionable. More justified would be the use of this information as a simply economic argument arising from the cost-benefit analysis and not as one based on ethics.

ii. Other Investors

Another argument against insider dealing is based on a presumption that it is unfair to small investors and that it discourages them from investing on the financial markets.[205] Very often the critics of insider dealing compare this behaviour to violation of the rules of the games. In their opinion the insiders have unjust advantages or play with "marked cards".[206] Such informational privilege of insiders may discourage the other persons from investing on a stock exchange. The objective of the insider dealing laws, including the Market Abuse Directive, is to restore the confidence of all investors to the market.[207]

However, the assumption about unfairness of insider dealing towards other investors has not been confirmed as far by empirical research. On the contrary, some analyses showed that the number of small individual investors on the stock exchange in the United States increased importantly during the 1980s. It happened despite the many cases of insider dealing that were reported at the same time.[208] It means that they were not discouraged by the fact they were allegedly competing with insiders.

The opponents of the "game with marked cards" argumentation consider that this statement is not justified. They underline the difference between sport games and financial markets. In the first case, the success of one player means the defeat of another. On the financial markets, however, as long as no one is forced to trade against his own will, parties enter into agreements that they both find satisfying.[209]

[205] REICHMAN, Nancy, *Insider Trading*, Crime and Justice, Beyond the Law: Crime in Complex Organizations, 1993, Vol. 18, p. 57.

[206] WERHANE Patricia H., *The Indefensibility of Inside Trading*, Journal of Business Ethics, 1991, No. 10, pp. 729 –731.

[207] Market Abuse Directive, recital 12.

[208] YOUNG, David S., *Insider Trading: Why the Concern?,* Journal of Accounting, Auditing and Finance, 1985, No. 8, pp. 178–183.

[209] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing*, Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 5.

Moreover, all market participants are *ex ante* aware of the rules that are applied to the "game" and the fact that some players are better informed than others.[210]

Another argument against insider dealing prohibition is also oriented against the regulations imposing obligatory disclosing of information before trading. It makes an analogy with the patent regulation. The scientific institutes are not obliged to share their knowledge with the small laboratories or independent inventors. The protection given by patents let them profit from their achievements. Meanwhile, the laws against insider dealing require full disclosure of the company's secrets and let the outsiders make an effortless profit on a basis of information that was elaborated by the issuer.[211]

Nonetheless, the latter argument does not take into account a considerable issue. In case of insider dealing, in most situations, inside information concerns a listed company. The shares in this company are in the possession of many persons – insiders, understood as persons working for the company, and also "external investors", i.e. shareholders who do not have any contractual link with the issuer beside the capital participation. Therefore, it would be possible to make a distinction between persons that already possess shares in a company and "outsiders", i. e. only potential investors. An "external investor", who sells his shares without full knowledge about a company, even if he achieves the price that he finds satisfying at a given moment, maybe would act differently if he had full knowledge of facts. He is, as an owner of shares, an owner of a part of the company.[212] Being in such a position should give him equal access to information. However, being "only" a shareholder, he does not have the same rights and possibilities to have access to the inside information as an insider. Thus, he may find the better informed insider's deals unfair. For that reason, these anti-regulation arguments seem to be justified only towards "outsiders". They do not have any link with the company.

The opponents of the "patent" approach consider that the "equal access to information" rule should be applied to all investors including the last group, i.e. so called "outsiders". They find the transaction unfair if the rule of equal access to information is violated, i.e. if each party to the transaction had different opportunity to learn about the inside information.[213]

On the other hand, the supporters of free insider dealing underline the importance of the distinction between the insiders and other investors, even those who are already shareholders. They present insiders as those who devoted their efforts to achieve the position that lets them get an access to information. Meanwhile, the

[210] MA, Yulong, SUN, Huey-Lian, *Where Should the Line Be Drawn on Insider Trading Ethics?*, Journal of Business Ethics, 1998, No. 17, pp. 67–75.

[211] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing*, Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 5.

[212] And even though, according to the Market Abuse Directive, he is a primary insider.

[213] BRUDNEY, Victor, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws,* Harvard Law Review, 1979, Vol. 93, No. 2., pp. 339–343.

other shareholders are just making their investment decisions quite randomly. Thus, they are not comparably entitled to achieve the valuable data.[214]

Moreover, the opponents of insider dealing regulation underline that in case of acquisition of financial instruments by an insider, the other party of the transaction, the seller, would sell his instruments anyway, to the insider or to any other interested person.[215] This approach is supported by the fact that the typical case of insider dealing relates to the deals made by intermediary of the stock brokers between anonymous market participants. An insider does not know to whom he sells his financial instruments or from whom he acquires them. Similarly, another person dealing on the market does not know from whom the shares are bought or to whom they are sold. Therefore, it would be very difficult to find someone harmed by these deals, while they were made by anonymous market participants. That is reason why insider dealing regulation opponents underline that it is a victimless behaviour and there is no reason to punish it.[216]

Another argument is that the agreements entered into by insiders may be detrimental to other market participants (e.g. when they dispose of the financial instruments whose value will probably rise) but they may be also beneficial for them (e.g. when they sell the financial instruments triggered by the drop of the value provoked by an insider's transactions). Hence, it would be very difficult to detect who was victimised by insider dealing, and to what extent. If small investors are harmed, it is so because of the fact that they do not have full information about the financial instrument, but prohibition of insider dealing does not increase their knowledge and, thus, does not prevent this harm.[217]

iii. Employer

When an insider engages in inside dealing, he makes a profit on the basis of information that was "produced" by the issuer, e.g. his employer. Therefore, the opinion may be supported that this information should be possessed and controlled by the entity that produced it. Such allegation is especially relevant with regards to the definition of insider dealing accepted in the United States. As it is presented in the first part of this chapter the prosecution of insider dealing in the European Union and in the United States differs importantly. Member States of the European Union accepted the solution where every use of inside information is unlawful (with small

[214] MCGEE, Robert W., *Ethical Issues in Insider Dealing: Case Studies*, Proceedings of the Global Conference on Business Economics, Association for Business and Economics Research, Amsterdam, 9–11 July 2004, pp. 712–721.

[215] MCGEE, Robert W., *Applying Ethics to Insider Trading*, Journal of Business Ethics, 2008, Vol. 77, pp. 208–209.

[216] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing*, Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 8.

[217] MOORE, Jennifer, *What is Really Unethical About Insider Trading*?, Journal of Business Ethics, 1990, Vol. 9, p. 177.

and strict exemptions). Meanwhile, American case-law evolved towards protection of inside information as a property of the company towards which the insider has contractual duties. Therefore, the accent is put on the internal fiduciary relation between employee and his company. However, similarly as in the European Union, the prosecution of insider dealing in the United States of America is exerted by the administrative authority.

Analysing the American insider dealing prohibition, some authors doubt whether the application of public law is justified and whether the issue should not be regulated by contract law and special provisions put in the contract binding parties.[218] This argumentation does not criticise insider dealing prohibition *per se* but just the way it is regulated. Instead of mandatory public prosecution, a more justified solution would be private enforcement and liability for violation of provisions of labour contract.[219]

iv. Insiders

Finally, during the discussion about the possible harms provoked by insider dealing the opponents of insider dealing regulation underline that the regulation itself victimises the insiders. They are forced not to make use of their knowledge in spite of the fact that such behaviour allegedly does not harm anybody.[220] This kind of statement, although may be seen as a kind of paradox and just emanation of someone's sense of humour, merits some attention. Simply, it should be remembered that if the arguments against regulation of insider dealing were found convincing, the existence of such a prohibition and limitation of the insiders' (understood as issuer's employees) and others' (who learnt about inside information) possibility to enter into transactions inevitably would be regarded as harmful and unfair for them.

2 Fraud

The insider dealing critics allege that insider dealing is a form of a fraud because the insider does not disclose all material facts to the persons he is dealing with. This argument refers to the informational inequality discussed in section "Advantage of Superior Knowledge" above but puts pressure on a conscious concealment of inside information by a dealing insider.

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[218] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing*, Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, pp. 13–14.

[219] See: Sect. C, Chap. 4.

[220] MCGEE, Robert W., *Applying Ethics to Insider Trading*, Journal of Business Ethics, 2008, Vol. 77, p. 210.

The opponents of this fraud-based approach try to disprove this argument with the help of the authority of Saint Thomas Aquinas.[221] Saint Thomas analysed the market (in his times it was a wheat market) and stated that there was no fraud if a seller did not inform a potential buyer that the prices of the given product would change importantly in the near future. Moreover, he stated that there was not even a moral duty to do so.[222] The example given in the thirteenth century matches perfectly the insider dealing cases. An insider disposes of, or acquires, financial instruments without informing anybody about the future change in their value that is known to him but not to other market participants. Because a transaction usually takes place with the intermediary of stock brokers, he even does not have to hide his knowledge, but just presents his offer. And his contractor just makes his decision about entering into an agreement without verifying whether he deals with an insider or another market participant.

3 Easy Gain

One of the possible reasons of the aversion towards insider dealing is that it potentially lets an insider gain an important amount of money in a short period of time and without any visible effort. That can lead to a conclusion that this profit was made in an unjust or unethical way, like a theft. For example, in his work concerning the pro- and against-regulation arguments, Stephen M. Bainbridge states: "*Generally, insiders outperform market returns by two to eight per cent. These substantial gains are justifiable only by a significant improvement in market efficiency*."[223] The issue of improvement in market efficiency is analysed in the section dedicated to economic arguments. Here, it should be only noted that the author of the cited statement finds unacceptable the fact that some market players may make bigger profits than others if it is not compensated by the other factors, such as e.g. better performance of market.

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[221] MCGEE, Robert W., *Ethical Issues in Insider Dealing: Case Studies*, Proceedings of the Global Conference on Business Economics, Association for Business and Economics Research, Amsterdam, 9–11 July 2004, pp. 712–721.

[222] St. Thomas Aquinas, Summa Theologica, II-II, Q. 77, art. 3(4) citation after: Summa Theologica, by St. Thomas Aquinas, [1947], at sacred-texts.com *"…for instance, if the seller carry wheat to a place where wheat fetches a high price, knowing that many will come after him carrying wheat; because if the buyers knew this they would give a lower price. But apparently the seller need not give the buyer this information. … in the case cited, the goods are expected to be of less value at a future time, on account of the arrival of other merchants, which was not foreseen by the buyers. Wherefore the seller, since he sells his goods at the price actually offered him, does not seem to act contrary to justice through not stating what is going to happen. If however he were to do so, or if he lowered his price, it would be exceedingly virtuous on his part: although he does not seem to be bound to do this as a debt of justice."*

[223] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 44.

This is the kind of argumentation that Ludwig von Mises, an Austrian economist, called "anti-capitalistic mentality".[224] It presumes that the increase in assets of one person must lead to impoverishment of another person. In case of insider dealing, this approach does not take into account a few important factors. First, being an insider is a result of the efforts necessary to achieve such a position. Usually, it is not just a matter of luck. Therefore, the financial gains are not a "lottery win" but a result of work. Besides, the financial market is not a zero sum game. The success of one party does not equal the defeat of another. No one is forced to deal and all transactions are entered into by parties willing to do so. Because of the anonymous character of most of transactions, there is no place for misleading purposefully the unaware party. Finally, no rule, whether legal or ethical, provides the obligation that a financial gain in order to be ethical must be linked with a great effort or even suffering. Many different professions are characterised by different work conditions and one cannot be condemned because of his less demanding character of work.

In consequence, such an approach can be seen as an example of a simple envy that someone is capable to make bigger profits than others. Under any circumstances envy should not be used as a justification of any law and for sure it is not an ethical explanation for a prohibition.

II Economic Arguments

The economic analyses try to answer the very similar question as the one asked by ethicists, i.e. whether insider dealing should be regulated. However, while analysing the deals between uninformed and well informed market participants, economists try to find out, instead of analysing the fairness of transaction, how such transactions influence the market and whether they impair market welfare.

There are two key factors that make the economic analysis of insider dealing very difficult. First, in most states it is a forbidden behaviour. Therefore, there is no official data about the number of conducted transactions and their circumstances. Instead, only theoretical estimations or official judicial statistics can be analysed. Secondly, because of the nature of this action, even in the states where insider dealing is legal, the observation of its popularity is not easy. In consequence, research has to be based on theoretical models or try to assess the visible occurrences. For those reasons, their final results may differ significantly.

The most popular economic arguments used in a discussion against insider dealing include: the discouragement of small investors from dealing, reduction of market liquidity, bigger volatility of the prices of financial instruments.[225]

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[224] von MISES, Ludwig, *The Anticapitalistic Mentality*, 1956, accessible at: www.libertarianpress.com.

[225] LELAND, Hayne E., *Insider Trading: Should It Be Prohibited?,* The Journal of Political Economy, 1992, Vol. 100, No. 4, p. 860.

Proponents of freedom of insider dealing also hold some strong arguments supporting their opinion. Among them one can find: bringing new information to the market through the transactions of insiders and, in consequence, making prices of the financial instruments more just, increasing the asset prices and, surprisingly, encouraging more investment on the stock exchanges.[226]

One of the difficulties associated with the economic analysis of the insider dealing restrictions is that many of used arguments are not contradictory. They just refer to and examine different aspects of the same phenomenon. As a result, the economic analysis may confirm correctness of both sides' opinions.[227]

Below, the main economic arguments used to support and criticise the regulation of insider dealing are presented.

1 Distribution of Information

Accurate pricing of financial instruments is one of the crucial elements of the proper market functioning. The price should reflect the actual value of the entity they relate to. In case of the divergence, a financial instrument is underpriced or overpriced. Both situations are detrimental for investors. The overpriced financial instruments create risk of a sudden drop in value and destruction of the savings of the surprised investors. Meanwhile, the underpriced securities deprive their owners of the possibility to earn adequately to their value. A financial instrument is correctly priced when all information relating to it had been publicly disclosed.[228] Not always, however, would disclosure of all information be beneficial for the entity issuing financial instruments and for their holders. Thus, the Market Abuse Directive provides that inside information relating directly to the issuer should be publicly disclosed as soon as possible but provides also a possibility to delay the public disclosure if the legitimate interests of issuer require it and such omission would not mislead the public.[229] Therefore, the European legislature accepts the situation when not all information is made public. Moreover, the obligation concerns only inside information relating directly to the issuer. For obvious reasons such obligation does not cover the information relating to it only indirectly. In many cases the issuing entity learns about this indirect information together with the other market participants. But it does not mean that the issuer always has no knowledge of such facts. Even if the issuer is not the source of the information, he may possess it before it is known to the public.

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[226] LELAND, Hayne E., *Insider Trading: Should It Be Prohibited?,* The Journal of Political Economy, 1992, Vol. 100, No. 4, p. 860.

[227] LELAND, Hayne E., *Insider Trading: Should It Be Prohibited?,* The Journal of Political Economy, 1992, Vol. 100, No. 4, p. 862.

[228] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 44.

[229] Market Abuse Directive, Article 6(1) and 6(2).

This flow of information on a market inspired the economists when they analysed insider dealing. Their researches resulted in two contradictory theses. Some claim it is beneficial to the market. Others assert that activity of insiders is detrimental for other investors.

a) Improvement of the Market Performance

The most famous economic arguments against insider dealing regulation based on the flow of information on the market were presented in 1966 by Henry G. Manne.[230] Since then, his theory has been subject of researches of economists. In result, they present arguments both in favour and against Henry G. Manne's thesis.

Henry G. Manne found insider dealing laws unjustified and claimed that this behaviour was beneficial for markets. His main economic argument is based on the assumption that insider dealing helps spread the information on the market. Insiders, while dealing create market trends and influence the price of given financial instruments. Thanks to these trends, the price starts to reflect the proper value of financial instruments being object of transaction. And as a proper value should be understood the value financial instruments should have when all relating to them data are taken into account. Even if inside information has not been made public, the behaviour of insiders allows investors to draw proper conclusions and gives an indication for a future trend on the market.

This approach met very vigorous reaction of other market specialists. Their arguments varied from the thesis that deals made by insiders are not able to move the financial instruments prices,[231] to consideration that insider dealing does not correct mispricing.[232] Although finally most of the economic experts agreed that insider dealing influences the prices of financial instruments, some economists as a crucial argument against it used the fact that insiders are able to make more profit on their transactions than other market participants.[233] In that way they referred to the ethical issue, by implicit question on whether it was fair that someone could make more profit than others under the same circumstances.

Provided that the theory that insider dealing moves the market prices of financial instruments is accepted, the beneficial influence of insider dealing for the market performance may be shown by analysis of the American case TGS, presented in the first part of this chapter (Figs. 1.1 and 1.2).

[230] MANNE, Henry G., *Insider Trading and the Stock Market*, New York, 1966.

[231] CHAKRAVARTY, Sugato, McCONNEL, John J., *Does Insider Trading Really Move Stock Prices?*, The Journal of Financial and Quantitative Analysis, 1999, Vol. 34, No. 2, pp. 191–209.

[232] MENDELSON, Morris, *The Economics of Insider Trading Reconsidered*, University of Pennsylvania Law Review, 1969, Vol. 117, No. 3, p. 475.

[233] LELAND, Hayne E., *Insider Trading: Should It Be Prohibited?*, The Journal of Political Economy, 1992, Vol. 100, No. 4, pp. 859–887.

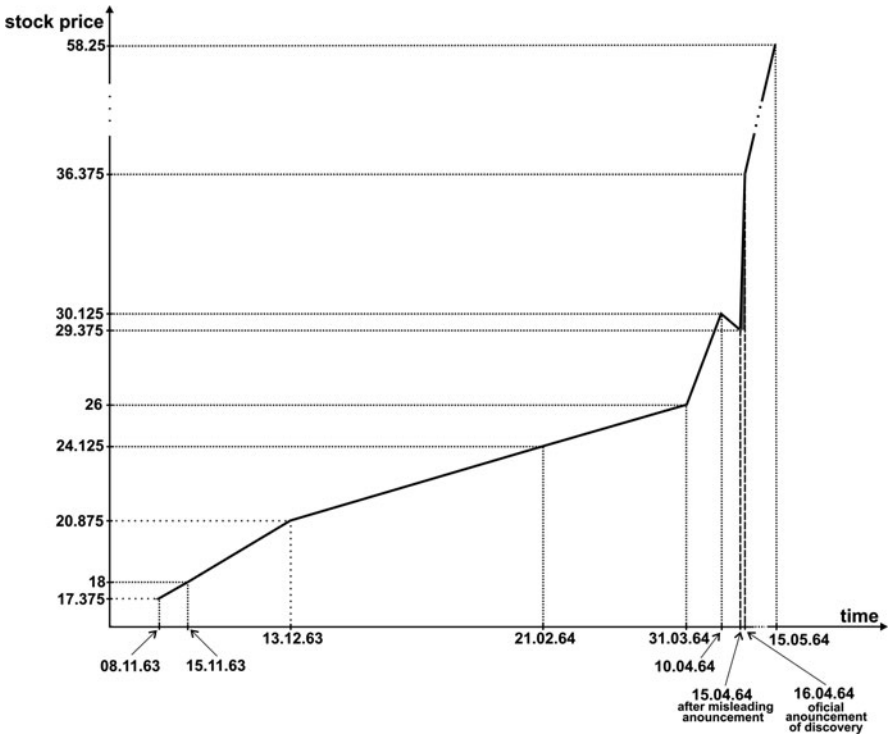

Fig. 1.1 Actual changes of the value of the shares of Texas Gulf Sulphur between 8 November 1963 and 15 May 1964

Figure 1.1 demonstrates the actual changes in prices of shares that took place in the TGS case. As it was described, the discovery of a rich ore deposit was kept secret during several months in order to realise the land acquisition programme. However, a group of insiders violated the internal rule of confidence and acquired shares in the company.[234] The fact that the information about discovery was not publicly disclosed till the April 1964 was evaluated by the Court of Appeals as justified. It led to the acquisition of the plots of land in the area for lower prices and was beneficial for the company. During five-and-a-half months (since 8 November 1963, when the drilling in the allegedly rich in ore area begun, to 16 April 1964, when the results of the discovery were publicly disclosed) the share value had doubled. The only decline in its value took place after a quite imprecise and potentially misleading announcement issued by TGS on 12 April 1964. In this announcement, the representatives of the company tried to quell the rumours about the importance of the discovery. Moreover, Fig. 1.1 shows that the real value of the

[234] *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969), presented in the section of this chapter dedicated to the American insider dealing regulation.

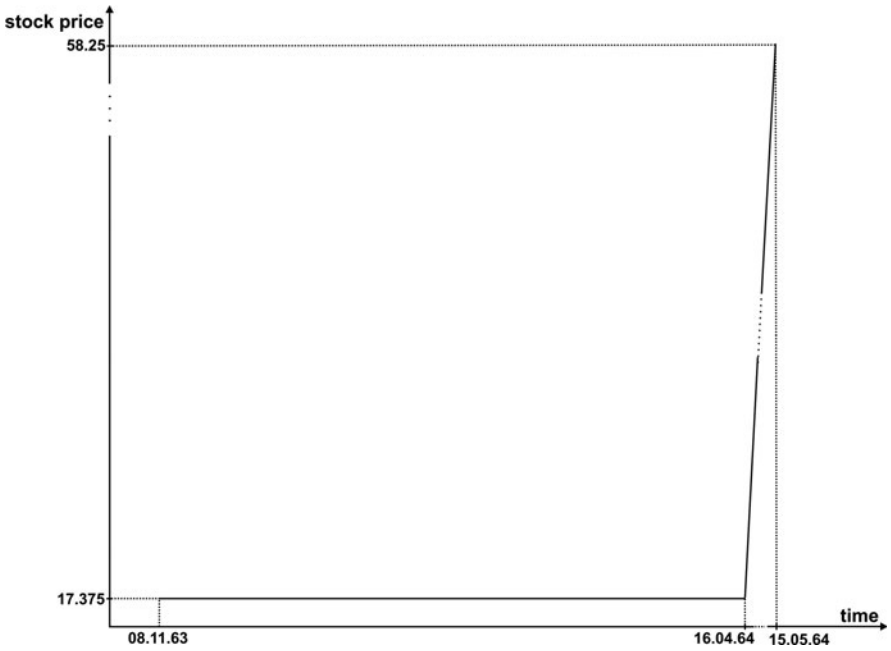

Fig. 1.2 Hypothetical changes of the value of the shares of Texas Gulf Sulphur between 8 November 1963 and 15 May 1964

company after the discovery of the ore strike was not completely reflected in the value of its shares till May 1964. However, thanks to the deals of the insiders that had knowledge about the ore discovery and the rumours that appeared on the market as a consequence of the increased investments, the price increased twice before the public announcement of the good news. That means that insider dealing adjusted the price of the shares and brought it closer to the value these financial instruments should have had.

Another hypothetical situation is presented in Fig. 1.2. If there was no insider dealing and, in consequence, no rumours would spread on the market, there would be no modification of the shares' prices. In consequence, the price index would be probably similar to the one presented on the second figure. The price of a share would be more less the same till the public announcement would be made. Only after the public disclosure would the value of financial instruments reach the appropriate level that would reflect the increase in the assets of the company.

These changes in value should be analysed from the point of view of a small investor. For him, the most advantageous situation would take place if he knew about the ore discovery from the beginning. If shareholders had such knowledge, the value of the shares would increase swiftly in order to achieve the appropriate level reflecting the importance of the finding. However, as it was said above, a quick announcement would paralyse the land acquisition plan. Therefore, keeping the information confidential was essential for the well-being of the company and

making a proper use of the discovery. Nonetheless, the deals made by insiders moved the price of the shares closer to the real value they should have had at that time. If there was no insider dealing any shareholder that would sell his shares in the period between November 1963 and the public announcement in April 1964 would receive the smaller price than in the case when the insider already influenced the price. In fact, such price would be less fair and more detrimental for him that the price that occurred as a result of insider dealing.

As it can be seen in Fig. 1.1, the only negative for small investors' movement in the price of the shares took place after the announcement of 12 April 1964 which tried to undermine the importance of the market rumours about the discovery. It provoked confusion that lowered the price of shares till the reliable public announcement few days later. It only shows the importance of the fair and transparent information presented to the market by the companies and how easy it is for an issuer to mislead the investors.

A similar analysis, with the similar results could be also made in a case when the value of financial instruments is overpriced and insiders who know about it start to sell their shares. If they create a trend, the prices of shares start dropping. Anyone who sells his shares before the public announcement of bad news would lose less than in the case if there was no previous indication and the price would drop dramatically from one day to other. And even if a shareholder does not sell his shares in a period of time between the beginning of a dropping trend and the announcement of the bad news, he cannot claim that he was deceived, because in both cases (with and without insider dealing) the shares would finally achieve the proper price, reflecting their actual value.

An issue might be raised on whether it is fair that insiders in any case would lose less or would gain more than other market participants. This point is analysed in the previous section dedicated to ethical arguments and the fairness of making profits on a basis of superior knowledge. However, from an economic point of view, it might be argued that maybe it is the price that other market players pay in order to get more information about the probable changes in value of the financial instruments.

Another aspect is this discussion is the issue of profitability of inside deals. Also in this domain the researches are not unanimous.[235] However, generally more authors suggest that insiders make more profit than other market participants. Once again, this conclusion refers to ethical issues of insider dealing.

b) Negative Approach Towards Insider Dealing

The opponents of the Henry G. Manne theory claim that insider dealing may lead to postponing the proper disclosure of information to the public. Firstly, as it was

[235] See discussion and references of research in: MENDELSON, Morris, *The Economics of Insider Trading Reconsidered*, University of Pennsylvania Law Review, 1969, Vol. 117, No. 3, p. 479.

mentioned above they contest the thesis that insiders' deals may help inform the other market participants about the future variations of the financial instruments' prices. Moreover, they underline the importance of the fact that if disclosure were made promptly and properly there would be no chance for an insider to profit from inside information.[236] Thus, according to this theory, insiders are oriented on delay of the flow of information within the entities where they work as well as within the whole market.

i. Delay in Internal Transmission of Information

In order to act efficiently, the flow of information within a company should be fast and complete. The possible distortions and delays may appear especially in large hierarchical companies. In such situation, the external entities have more time to acquire the information, thus, it may be detrimental for the company that "produced" it. According to the supporters of insider dealing regulation, the risk of delay exists particularly when the managers want to use the information for their own purposes before they transmit it to their superiors. Even if the delay is not long, when information passes through a few hierarchical stages, it may become substantial and hinder the corporate decision-making.[237]

On the other hand, proponents of insider dealing consider that such delay would occur anyway and additionally claim that any potential acquisition or disposition of financial instruments would be reflected in their price. Therefore, insider dealing would make it easier for managers to supervise any possible obstructions in the flow of information within the issuer and detect the important information not yet delivered to him officially. It is enough that they should supervise the fluctuation of the price of financial instruments.[238] A question may be asked on whether the trades made on an interim level would really have such an impact on the prices of the financial instruments that they could be observed.

ii. Delay in Public Disclosure of Information

The possibility of insider dealing may create the incentives to delay the public disclosure of inside information in order to have more time for insiders' transactions. Hence, even if there is no legitimate interest to keep the information

[236] MENDELSON, Morris, *The Economics of Insider Trading Reconsidered*, University of Pennsylvania Law Review, 1969, Vol. 117, No. 3, p. 473.

[237] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 50.

[238] MANNE, Henry G., *Insider Trading: Hayek, Virtual Markets, and the Dog that did not Bark*, Journal of Corporation Law, Vol. 31, No. 1, Fall 2005, pp. 167–185.

confidential, insiders may prefer not to inform public about it as soon as it is possible.[239]

The opponents of this argument underline that, similarly as in the case of internal delay, the delay provoked by insider dealing are insignificant. The empirical evidence presented by Michael Dooley in his research made on 37 reported cases of insider dealing between 1966 and 1980 showed that only in one case was the disclosure delayed.[240] These data are based on a small sample; however, they may give some indications about the real influence of insider dealing on the delay of information. The other argument is that even if not disclosed officially, inside information would be reflected in the price of financial instrument.

Besides, the issue of delay in disclosure of the information to the public seems to be independent from the issue of insider dealing. They can occur together, but each of them may also appear independently. In the European Union, the proper disclosure of information is dealt with in a separate part of the Market Abuse Directive as well as in the distinct Transparency Directive.[241] Thus, although there might be established a relation between insider dealing and delay in public disclosure (the first is more likely to occur alongside the second), prosecution of insider dealing seems to be just a punishment of a scapegoat. The real concern should be the creation of a legal environment that coerce the proper disclosure of the inside information to the market.

2 Influence on Distribution of Negative Information

Another argument in the economic debate makes reference to the fact that within the notion of insider dealing there might be distinguished different kinds of this behaviour. All insider actions may be divided into two groups: those based on negative information and those based on positive information. Information is negative when its disclosure would lead to the decrease in value of a financial instrument. Conversely, it is positive when it would lead to an increase. Depending on the positive or negative character of information some economists are willing to differentiate the insider dealing prohibition and apply it only to deals made on the basis of positive information.[242]

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[239] BAINBRIDGE Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 53.

[240] DOOLEY, Michael P., *Enforcement of Insider Trading Restrictions*, Virginia Law Review, 1980, Vol. 66, No. 1, presented after: BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 55.

[241] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390, 31.12.2004, pp. 38–57.

[242] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28.

The justification of such an approach is as follows. The persons responsible for managing an issuing company are more willing to disclose positive information. The increase of the value of the issuer reflected in the value of its financial instruments is usually presented as an achievement of the disclosing persons and it is revealed for the reputational reasons, additional bonuses, etc. Similarly, such incentives do not exist in case of negative information.[243] In consequence it is presented to the public with a delay. However, insiders, through their transactions, spread the information in the market. Of course, it is made indirectly through the mechanism described in the point 1. above. But this way the market receives the information. As the positive information would be disclosed anyway, allowing the insiders trade on its basis would give them only a possibility of additional profit. Meanwhile, permission for insider dealing on a basis of negative information would let it become public before the managers would disclose the inconvenient truth. Therefore, inside dealing on the basis of negative inside information should be permitted.[244]

According to this theory, legal insider dealing based on negative information seems to be a more efficient tool of distribution of information in the market than duties of disclosure. There is no need of enforcement agencies that would detect and prosecute the violation of duty of disclosure. Moreover, transactions could be conducted by all insiders in possession of negative inside information. Meanwhile, a decision about disclosure is taken only by few of those having access to it. In consequence, more precise data would reach the market. It would be a result of an aggregation of the total amount of transactions understood as signals to public. Of course, disclosure through insider dealing is indirect because it does not reveal the content of the information but just the decline in the value of financial instrument. However, insider dealing can efficiently supplement the existing disclosure duties.[245] And for investors in the market the most important is that the price of financial instruments reflects accurately their real value without the need to collect and process accessible data.[246]

Besides, insider dealing based on negative information does not violate the rights of the other holders of given financial instruments. The value of the issuer has already dropped and before the information is revealed the financial instruments

[243] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 4.

[244] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 4.

[245] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 5.

[246] ENGELEN, Peter-Jan, LIEDERKERKE, Luc V., *The Ethics of Insider Trading Revisited*, Journal of Business Ethics, 2007, Vol. 74, p. 503.

that should reflect it are simply overpriced. The action of insiders just accelerates the acquisition by financial instruments their proper value.[247]

This theory refers also to another issue. Insider dealing prohibition may facilitate creation of collusive agreements between insiders aiming at withholding negative inside information from the market. The risk of prosecution makes the parties to the agreement more willing to respect this unfair deal, because others would possibly report the "traitor" to the competent authority. Meanwhile, on a market where insider dealing is allowed, the parties to such agreement would compare the potential benefits from dealing in financial instruments and from concealing the information. That would potentially destabilise such agreements and reduce their importance.[248]

The concern linked to the legalisation of insider dealing based on negative information is that such a regulation would encourage insiders to create negative information in order to make use of it. However, in the long term creation of negative information would provoke a loss of reputation of an insider. This kind of information would simply mean that he is incapable to fulfil his duties, i.e. to improve the performance of the entity he works for. In consequence, such actions would be more detrimental than beneficial for their author.

Additionally, in order to discourage insiders from creation of negative information, the supporters of insider dealing based on negative information propose a regulation that would allow make a use of information only by insiders that have not produced it.[249] Such solution seems, however, to be very costly in detection and practically impossible to respect. It would require verifying in every case the exact origin of the negative information. In big entities, where the information is a result of many different decisions taken within a complicated procedures, every participating insider would be potentially an author of the information. Another possible solution, already existing in the United States, would be the prohibition of short selling by insiders. When they can dispose of only the financial instruments they already possess, they have no motivation to produce negative information. Selling in such situation can only reduce their losses but never bring any profit.[250]

3 Compensation

The other pillar of Henry G. Manne's economic theory is the role of insider dealing in compensation of inventive employees. This claim is based on an assumption that

[247] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 6.

[248] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 7.

[249] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 9.

[250] GRECHENIG, Kristoffel R., *Positive and Negative Information - Insider Trading Rethought*, 2007, University of St. Gallen Law & Economics Working Paper No. 28, p. 9.

only insider dealing permits to compensate the employees with the real value of the new innovations.[251] In this way an insider is encouraged to work effectively for the company and to increase its value. The other possible means of gratification, e.g. stock options or pecuniary bonuses, are usually granted before the results of innovation are visible or reflect the welfare of the attributing company and not the importance of research. Meanwhile, by inside dealing, an inventor is able to compensate himself up to the level he considers appropriate.

However, the compensation theory may be attacked on different levels. First of all, a company to which the information relates may prefer not to disclose this information for a given period of time; otherwise such disclosure may lower its value. If the theory that inside trades influence pricing of the financial instruments and, thus, spread the information in the market is accepted, in order to prevent it, the company may choose to compensate its employees in a more classical way.[252] Moreover, some authors underline that this way of compensation is unjust, because it let wealthier employees to earn more (they are able to buy more financial instruments and enter into more profitable deals) than those with the limited savings.[253] Thus, the compensation does not reflect the personal contribution but only the access to the capital. The next argument relates to the fact that most of the innovations do not influence visibly the price of the related financial instrument. It is very rare that a given innovation (supposing that it is not a revolutionary cure for cancer) influences importantly the stock price. Therefore, the inventors could not be sufficiently compensated this way. The other objection might be that this way of compensation could be also used by those who had not participated in the research work and, in consequence, whose profit would not be linked to their efforts. In order to avoid it, employees should refrain from sharing their knowledge with their work colleagues until their transactions are made.[254] The other arguments include the risk of delay in distributing the information, and simply undermine the assumed impossibility of compensation of employees by using traditional means of gratification.[255] Besides, not all innovators are interested in a quite uncertain compensation scheme. Some of them, more risk-averse, may prefer traditional labour contract.[256]

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[251] MANNE, Henry G., *Insider Trading and Property Rights in New Information*, Cato Journal, 1985, Vol. 4, No. 3, pp. 935–937.

[252] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 47.

[253] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 48.

[254] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 48.

[255] MENDELSON, Morris, *The Economics of Insider Trading Reconsidered*, University of Pennsylvania Law Review, 1969, Vol. 117, No. 3, p. 488.

[256] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 48.

The other compensation based argument refers to the American understanding of inside information as a property of a company.[257] If such a model is accepted, there is no reason why a given company was not allowed to use this information as a one of its assets. An example of such a use could be the disclosure of information to a trusted selected outsider that benefited the company. It could be an efficient way of compensation for his services, without the direct cash flow between the interested parties.[258] Nevertheless, such argumentation can be applied only to insider dealing in the United States. The European protection is oriented on the unfairness of any inside deals and not only on property rights violation.

4 Reduction of Liquidity

An often repeated allegation is that insider dealing reduces liquidity of the market. A liquid market, i.e. one on which an investor may quickly and cheaply acquire or dispose of his financial instruments, encourages the small investors to enter on the stock exchange without risking that they will not be able to dispose of their investments.[259] The theoretical models of market liquidity after introduction of insider dealing regulation differ importantly as to the obtained results.

An empirical research conducted on the Amsterdam Stock Exchange showed that after introduction of insider dealing regulation, the liquidity of the market decreased[260] which demonstrates that the objectives of the legislature were definitively not achieved in this domain.

5 Increased Volatility of Financial Instruments Price Oscillations

Some authors consider insider dealing to be a source of the increased unpredictability of financial instrument prices. Because of that, a small investor does not enter the market because he fears not to have the same chances as others to succeed. In consequence, the capitalist order, understood as equal opportunities to increase individual's wealth, is destabilised.[261]

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[257] This theory is presented in the first part of this chapter.

[258] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing,* Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 19.

[259] ENGELEN, Peter-Jan, LIEDERKERKE, Luc V., *The Ethics of Insider Trading Revisited*, Journal of Business Ethics, 2007, Vol. 74, p. 501.

[260] KABIR, Rezaul, VERMAELEN, Theo, *Insider Trading Restrictions and the Stock Market: Evidence from the Amsterdam Stock Exchange*, European Economic Review, November 1996, Vol. 40, Issue 8, pp. 1591–1603.

[261] BUCKLEY, F.H., CONNELLY, M.Q., *Corporations: Principles and Policies*, 1988, referred to in MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing,* Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 9.

The opponents of this theory present the following contradictory arguments. First, they recall that increased volatility of stock prices does not undermine capitalist order. In their opinion this system can be damaged only if private property rights are violated and laws do not interfere to protect individuals against unjustified violence.[262] Besides, although increased volatility may actually reduce the market efficiency, this allegation does not justify the prohibition of insider dealing. There are many behaviours that might be considered inefficient (e.g. production of different models of the same device), but are fully accepted. Moreover, this justification should be applied only if the allegation about increasing volatility was accepted. Meanwhile, if the theory that insider dealing helps the market prices to reflect better the real value of a given financial instruments, such behaviour increases market efficiency and helps to reduce the unexpected changes in financial instruments' value.[263]

6 Property Value

Insiders are often accused of provoking changes in value of the financial instruments. Referring to this statement, another economic argument presented by opponents of insider dealing regulation is that no one can legitimately protest against the changes in value of the property they possess. Playing on a financial market does not guarantee success and one may make a big profit as well as lose his money. As long as insiders are not engaged in manipulation of the value of the financial instrument, i.e. behaviour focused on deliberately misleading others, the only influence they can have is on the trends on the market. And still there are some doubts on whether insiders' deals may create the market trends. It may be conservatively said that it depends on the structure of ownership and a value of trades they make. Therefore, the only possible allegation the other shareholders can raise against insiders is that their financial instruments lose their value.[264] However, the property rights do not include the value of our property.[265] A person may be accused for destroying somebody else's property, e.g. a picture. But nobody can accuse an art critic of expressing an opinion that decreases the price one can obtain for his piece of art. And in the case of the financial markets the value of the property, i.e. financial instrument depends on the current demand and supply of a

[262] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing,* Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, p. 10, ROTHBARD, Murray N., *The Ethics of Liberty*, Atlantic Highlands, 1989.

[263] MCGEE, Robert W., BLOCK, Walter, *An Ethical Look at Insider Dealing,* Andreas School of Business Working Paper, Barry University, Miami Shores, FL 33161, November 2006, pp. 10–11.

[264] On the other hand, a positive version with the increase of the value is also possible – but in such a case no one would probably complain.

[265] See HOPPE, Hans Hermann, BLOCK, Walter, *On Property and Exploitation*, International Journal of Value-Based Management, 2002, Vol. 15, No.3, pp. 225–236.

given kind of instruments. Even if there is a decreasing tendency, no one is deprived of his property rights.

If such an approach is applied, the future fluctuation in the value of the financial instruments does not influence the evaluation of the transactions conducted by insiders. The persons who deal with insiders pay or receive the price that is fair at the moment of the transaction. Any changes in value that can take place in the future are irrelevant because the price has to be estimated at the moment when the deed is executed.

7 Influence on Governance Mechanism

An additional economic research analyses the influence of the insider dealing prohibition on the governance mechanisms within the companies.[266] It is based on an assumption that active shareholders are indispensible in the system of corporate governance. They are able to monitor and assess the activity of the company's managers. Of course the shareholders that hold larger amount of shares have more possibilities to influence the executive decisions. The American regulation of insider dealing puts many restrains on shareholders that hold more than 10% of the shares.[267] The Market Abuse Directive reaches even further and enumerates all shareholders as potential primary insiders.[268] Naturally, the shareholders with bigger holding in capital of the issuer will be more easily presumed to have access to inside information. Therefore, an unexpected outcome of the insider dealing regulation might be that investors would not be longer interested in holding larger blocks of shares. In the United States, that means remaining under the threshold of 10%, but in the European Union the participation might be even smaller and linked with quite passive execution of the shareholder's powers. Such behaviour limits their influence on the structure of the management, the supervisory board and monitoring the current performance of the managers. Moreover, investors, in order not to limit the liquidity of their financial instruments, will not be interested in the profound knowledge about the entity, i.e. in learning about the inside information. It concerns especially institutional investors, like pension funds, which, in order to fulfil their duties toward their own shareholders, are obliged to maintain their market flexibility. Without inside knowledge, they have no means to control effectively the issuer. And the managers, that are out of the shareholders' monitoring, may more easily adopt an self-interested attitude instead of the one concentrated on the performance of the issuer.

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[266] PADILLA, Alexandre, *The Regulation of Insider Trading as an Agency Problem*, 31 May, 2005, bepress Legal Series, Working Paper 641, accessible at: http://law.bepress.com/expresso/eps/641 (last seen on 19 June 2009).

[267] Securities Exchange Act of 1934, Section 16 and 16(a).

[268] Market Abuse Directive, Article 2.1(b).

The confirmation of this theory could be found in an empirical analysis that shows that, in the countries where insider dealing regulation is enforced, there is lower ownership concentration than in other countries.[269]

8 Link to Market Manipulation

Some documents, e.g. the OECD Principles of Corporate Governance, refer to insider dealing as to the behaviour that leads to market manipulation.[270] Thus, they argue that because of this reason it should be prohibited. Meanwhile, it is difficult to find a direct link between insider dealing and market manipulation. The latter behaviour consists of misleading transactions that are supposed to create false signals as to the value or demand of the given financial instrument or of dissemination of false information that has similar effect.[271] The essence of market manipulation is to mislead purposely other market participants. The objective of an insider is to acquire or dispose of financial instruments which value shall change, according to his best knowledge. The fact that he knows more than other market participants allows him to predict the future flows of the value more accurately. Thus, the transactions made by an insider disclose some information about the real actual value of given financial instruments. If they are overpriced, insiders would dispose of them and in case of a future increase of value, persons in possession of such knowledge would acquire them. The divergence between manipulation and insider dealing is considerable. Market manipulation provokes confusion on markets. Meanwhile, insider dealing can offer valuable clues about the future of market.[272] Creation of a parallel between insider dealing and market manipulation just because both concern financial instruments is unjustifiable.

9 Insider Dealing and Market Analysts

Some authors consider that allowing insider dealing would be harmful for the market efficiency and liquidity because insiders tend to use the inside information not in the moment when they learn about it but when they can make the biggest

[269] BENY, Laura Nyatung, *A Comparative Empirical Investigation of Agency and Market Theories of Insider Trading*, 1999, Discussion Paper No. 264. Cambridge, Massachusetts, Harvard Law School, James M. Olin Center for Law, Economics, and Busines. Accessible at: http://www.law.harvard.edu/programs/olin_center/papers/pdf/264.pdf (last seen on 19 June 2009).

[270] Annotation to Section II of the OECD Principles of Corporate Governance, 2004.

[271] Market Abuse Directive, Article 1.2.

[272] The Seattle Times, *When insiders sell stock*, 12 June 2009, Internet edition on www.seattletimes.com, last seen on 12 June 2009.

profit on its basis.[273] Therefore, this approach supports the idea of prohibition of insider dealing in order to increase the importance of the role played by the market analysts. When insiders are allowed to deal on a basis of inside information they outperform the results achieved by analysts and decrease their importance for the market.[274] They just have more precise, direct information about the performance of given companies and, moreover, their access to information is unlimited. The trades made by insiders disturb the analysis made by market analysts and make predicting the prices very difficult if not even impossible (e.g. when insiders are disposing of financial instruments because of the future decline in its value and an analyst does not know that the deals are made by insiders, he may consider that the instruments are underpriced and recommend their acquisition).[275] Meanwhile, in the environment where insider dealing is forbidden, the market analysts are more qualified to evaluate properly the value of financial instruments, because they have wider knowledge of the market and in their work they take into account not only the precise facts concerning a given company but also general market trends. Additionally, the analysts are more diversified than insiders and are able to generate a much higher volume of transactions, which increases market liquidity.[276]

The information processed by market analysts is distributed in the market by their personal advices and general announcements made to public (e.g. through financial websites).[277] The main difference between trades made by insiders and announcements of analysts is that the latter group informs the others directly and transactions of insiders give just an indirect suggestion about the future changes in the value of the financial instruments.

Although Zohar Goshen and Gideon Parchimovsky assume that distribution of information made by market analysts may be made for free or for a low fee,[278] it should be kept in mind that the main objective of analysts is to sell the information

[273] GOSHEN, Zohar, PARCHOMOVSKY, Gideon, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, Fordham University School of Law, Research Paper 06, September 2000, accessible at SSRN electronic library: http://papers.ssrn.com/paper.taf?abstract_id=242912.

[274] GOSHEN Zohar, PARCHOMOVSKY, Gideon, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, Fordham University School of Law, Research Paper 06, September 2000, p. 6.

[275] GOSHEN, Zohar, PARCHOMOVSKY, Gideon, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, Fordham University School of Law, Research Paper 06, September 2000, p. 10.

[276] GOSHEN Zohar, PARCHOMOVSKY, Gideon, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, Fordham University School of Law, Research Paper 06, September 2000, p. 6.

[277] GOSHEN, Zohar, PARCHOMOVSKY, Gideon, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, Fordham University School of Law, Research Paper 06, September 2000, p. 28.

[278] GOSHEN, Zohar, PARCHOMOVSKY, Gideon, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, Fordham University School of Law, Research Paper 06, September 2000, p. 28.

they possess. And any free distribution of some extent of the inside news may serve only as a kind of advertisement or promotion of their services. Therefore, the prohibition of insider dealing in order to promote market analysts may be considered as a relocation of the special benefits linked to inside information from insiders to specialists in market analysis. And that is the reason why market analysts are often considered as a group lobbying in favour of insider dealing regulation; not because of the market benefits of such solution, but because of their personal gain.[279]

10 Burden Put on Companies and the Whole Society

The opponents of insider dealing regulation underline that enforcement of these rules results in the high burdens put not only on companies but also on society as a whole.[280] First of all, companies, in order to comply with the regulation, must create and respect additional protection systems against the spread of information within them, generate and update regularly list of insiders, produce additional reports for the supervisory authority. Moreover, using money from the taxes paid by every citizen, states finance administrative authorities that supervise the compliance with the rules, as well as the public prosecution that inquires the prosecution cases. If the arguments of opponents of insider dealing regulation are accepted, such expenses are at least questionable.

11 Insider Dealing and the Financial Crisis?

Insiders, while dealing on inside information, use their knowledge about the future changes in the value of the financial instruments. Therefore, the supporters of insider dealing regulation emphasize the fact that, in order to increase the dealing profits, they may undertake risky decisions that would be likely to influence the value of the financial instruments. In consequence, their decisions would be based on the short-term predictions and in the long term could be detrimental for the company. Or they could opt for the riskier solutions that would also give them a possibility to make personal gains.[281]

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[279] HADDOCK, David D., MACEY, Jonathan R., *Regulation on Demand: A Privet Interest Model, With and Application to Insider Trading Regulation*, Journal of Law and Economics, October 1987, Vol. 30, No. 2, pp. 311 – 352, TIGHE, Carla, MICHENER, Ron, *The Political Economy of Insider Trading Laws The American Economic Review*, May 1994, Vol. 84, No. 2, pp. 164–168.

[280] MCGEE, Robert W., *Ethical Issues in Insider Dealing: Case Studies*, Proceedings of the Global Conference on Business Economics, Association for Business and Economics Research, Amsterdam, 9–11 July 2004, pp. 712–721.

[281] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 52.

So far, there has been no direct allegation that financial crisis that began in 2008 had any connotation with insider dealing. However, there is a strong assumption that it origins in the fact that the companies' directors were interested only in short term results. Their salaries were at least partially based on stock options or shares of the company. Thus, they were strongly interested in a visible increase in the value of the company, even if not based on its real performance, in order to realise their profits.[282]

However, this kind of argument should be applied to market manipulation and not to insider dealing. Trying to artificially influence the value of the financial instruments in order to achieve personal gains enters into scope of market manipulation practices. Therefore, allegations that link such actions with insider dealing would not be justified.

Besides, it may be argued that evidently insider dealing prohibition cannot protect the markets against financial crises. Both in the United States and in the European Union it is forbidden to deal on the basis of inside information. And it did not prevent the serious problems on these markets. Evidently, the generative force of the crisis should be looked for elsewhere.

III Conclusions

The objective of the second part of this chapter was to demonstrate the disparities existing between the economy and ethics specialists in their evaluation of insider dealing. After such a short presentation it is still impossible to answer a question whether insider dealing is beneficial or detrimental for the markets, fair or unfair. For many decades the specialists in ethics and economics have tried to find an argument that would convince others. But the war over character of insider dealing is still not over. As shown in the analyses above, the ethics and economic specialists are able to present the arguments both in favour and against this phenomenon. The force of their arguments is often incomparable, because they relate to different aspects of economy or ethics. Moreover, they are usually just hypothetical because there is very little empirical data concerning the issue and current prohibition does not allow collect them in more convincing amount. But it may be said that both parties to this discussion may present important remarks that should be taken into account when the decision about the shape of the regulation and scope of the prohibition is taken.

The arguments based on ethical premises try to analyse the unfairness of insider dealing. In spite of a common opinion, arguments that defend the conduct of the insiders may be found. By reference to the basic ethical notions and to different

[282] Thesis from presentation made by Prof. Dr. Theodor BAUMS during the Conference organised by the University of Luxembourg on 9 June 2009, "Corporate Governance in the aftermath of the financial crisis".

domains of human activity they try to show that insider dealing does not violate the rules of morality. Meanwhile, the economic analyses tackle with the issue of the market efficiency. The researches demonstrate that at least some insider dealing is beneficial for the market performance and it cannot be unequivocally seen as impairing the stock exchanges.

The objective of this section was to demonstrate that none of the specialists discussing about insider dealing may claim that he is in possession of the "final argument" that would definitively close the debate.[283] This is an often neglected aspect of the discussion on insider dealing. Currently, as it may be seen in the formulation of the Market Abuse Directive, arguments in favour of this behaviour are usually disregarded. Meanwhile, it should be remembered that the arguments that are used in order to justify introduction of the prohibition are also subject of critics and are not based on strong empirical data. In consequence, when all arguments are taken into consideration, a question may be asked on whether regulation of insider dealing is really needed and whether the current shape of the prohibition reflects that actual needs of the markets. A natural consequence of these arising questions is a concern whether application of criminal law in order to regulate this action is justified and whether it complies with the principles of criminalisation.

[283] BAINBRIDGE, Stephen M., *The Insider trading Prohibition: A Legal and Economic Enigma*, University of Florida Law Review, 1986, Vol. 38, p. 63.

Chapter 2
Practical Issues Arising from the Transposition of the Market Abuse Directive into the Chosen Member States' Legal Systems

The transposition of a directive into a national legal system is always difficult and it demands special attention in order to be properly conducted. Legal provisions, created by the European institutions on a supra-national level, have to become a part of the legal systems of all the Member States to which they apply. And each Member State has its own characteristics and judicial tradition. According to the constitutive acts of the European Union, a directive is binding as to the result to be achieved but the choice of the form and methods of transposition are upon each Member State.[1] Therefore, the provisions of every directive should precisely indicate their objective but they should also leave some room for the Member States' legislative activity. Meanwhile, directives are often used in order to regulate very precise domains that require high level of conformity between Member States.[2] Thus, they contain the definitions and rules that should be introduced into the national legal systems without any changes. In such cases, the Member States have only illusive powers of choosing the best method of transposition. Otherwise, they risk modification of the act.

In this chapter, the implementation of the Market Abuse Directive in four Member States will be presented. These Member States are France, Luxembourg, the United Kingdom and Poland. Each of them has a distinct legal tradition as well as a different stock exchange market and experience with fighting against insider dealing. All of them had to transpose the Market Abuse Directive into their national legal systems and establish the rules that would achieve its objectives. One of them is to reduce the disparities between national regulations. The comparison tries to verify how the Directive was transposed, whether, in result, the scope of insider dealing prohibition is the same in all of the mentioned Member States, whether the sanctions applied are criminal or administrative and, if possible, how the Directive is applied in practice. In order not to extend excessively the scope of the

[1] TFEU, Article 288, up to 30 November 2009: Treaty on the European Community, Article 249.
[2] E.g. Directive 2006/42/EC on machinery.

I. Seredyńska, *Insider Dealing and Criminal Law*,
DOI 10.1007/978-3-642-22857-5_2, © Springer-Verlag Berlin Heidelberg 2012

presentation, the provisions of the national regulations that repeat the wording of the Market Abuse Directive are not discussed here. Only the existent discrepancies and introduced modifications are tackled.

A General Remarks Concerning the Character of the Market Abuse Directive

The Market Abuse Directive should have been transposed into national legal systems before 12 October 2004.[3] By this time the Member States had to decide what system of protection against market abuses to create. Of course these systems have to comply with the Directive and all modifications should be made within the margin of freedom given by its authors.

Generally speaking, directives may be divided into two groups. First, there are directives that establish minimal rules that must be respected by the national act but which may be accompanied by additional regulations introduced on a national level. The second group includes the directives that must be transposed in a strict way and the Member States have no freedom to add any provisions that would modify them. Some authors expressed the opinion that the Market Abuse Directive contains only minimal rules and may be supplemented by the will of a national legislature.[4] This view makes an analogy with the provisions of the Insider Dealing Directive. It stated *expressis verbis* that each Member State might adopt provisions more stringent than those laid down by that act or even additional provisions if only they were applied generally.[5] The Market Abuse Directive does not contain such a provision and the conclusions concerning its character have to derive from more broad statements of the act. So far, the CJEU has not expressed its opinion on this matter. However, the advocate general, in her analysis of the Article 2(1) of the Directive stated that, besides the provisions that expressly refer to the Member States competences to determine the shape of the market abuse regime,[6] all other provisions of the Directive should be transposed into national legal systems without any modification.[7] Although her analysis concentrates on one concrete article of the act, the reasoning seems to be convincing also in relation to other provisions of the Market Abuse Directive. In practice, a majority of the provisions of the Market Abuse Directive does not make any reference to the competences of the Member States. Nevertheless, it does not mean that the Member States have only a technical duty to transpose the Directive without changes into their national systems.

[3] Market Abuse Directive, Article 18.

[4] MOLONEY, Niamh in *EC Securities Regulation*, 2nd edition, Oxford 2008, pp. 916–917.

[5] Insider Dealing Directive, Article 6.

[6] Such as they can be found in Article 6.1 (2) of the Market Abuse Directive.

[7] Opinion of Advocate General Kokott delivered on 10 September 2009 in Case *Spector Photo Group and Van Raemdonck* C-45/08, points 75−92.

The crucial task, i.e. the determination of how to properly and justly execute the market abuse prohibition, was assigned to the national legislatures.[8] The Directive imposes the introduction of administrative sanctions but does not determine their kind and burdensomeness. It requires only that they should be "appropriate."[9] Moreover, as it was presented in Chapter 1, the Directive permits the Member States to apply criminal sanctions to insider dealing. Many of them made eagerly use of this possibility and introduced criminal provisions into their regulations of both insider dealing and market manipulation. Application of criminal sanctions is possible in 28 of the 29 Member States.[10] Besides, the analysis shows that in every Member State the "appropriateness" of the administrative and criminal sanctions was understood in a different way.

B Presentation of the Selected Member States' Stock Exchange Markets

I France

France's experience with the stock exchange market started with the beginning of the industrial era and the increased need to acquire capitals for the new investments. As the years went by, it developed and became one of the important stock exchanges in Europe.[11] In order to compete effectively with other big stock exchanges, in September 2000 the French stock exchange in Paris merged with the stock exchanges of Amsterdam and Brussels, and formed Euronext N.V. Now, the London Financial Futures and Options Exchange and Portuguese stock exchange Bolsa de Valores de Lisboa e Porto also belong to the group. Moreover, in 2007, Euronext N.V. merged with the New York Stock Exchange and created the NYSE-Euronext holding.[12] Thus, Paris' stock exchange, now called Euronext Paris, is part of the worldwide entity that combined the New York Stock Exchange (the biggest in the world) and the second stock exchange platform in Europe (after the London Stock Exchange).[13]

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[8] Market Abuse Directive, Article 14.

[9] Market Abuse Directive, Article 14.1.

[10] Executive Summary to the Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD), CESR/08-099, February 2008, p. 2.

[11] For more details see: GOYEAU, Daniel, TARAZI, Amine, *La Bourse*, Paris, 2006.

[12] TRUSZKOWSKI, Jacek, *Euronext*, in: in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 47.

[13] PIEKARZEWSKA, Agnieszka, *Giełda papierów wartościowych w Wielkiej Brytani – London Stock Exchange*, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 41.

Nevertheless, one entity does not mean one market. Every company has to choose on which national market it wants to be listed, and then fulfil the requirements of the given state.[14] It does not exclude a dual listing (and even possibility of being listed on all stock exchanges that are members of the NYSE Euronext), but all entities listed on the Euronext Paris have to comply with French law, including in regard to the insider dealing prohibition.

The prosecution of insider dealing in France has a long tradition. It was introduced into the legal system by the law of 23 December 1970,[15] so shortly after the courts of the United States recognised the wrongfulness of insider dealing.[16]

The powers relating to the execution of the insider dealing prohibition are granted to the Financial Market Authority (*Autorité des marchés financiers*, hereinafter referred to as the "AMF"), the single administrative authority within the meaning of the Market Abuse Directive.[17] The entity was created in 2003 by the Financial Security Act[18] as a merger of three other institutions: the *Commission des opérations de bourse* (COB), *the Conseil des marchés financiers* (CMF) and the *Conseil de discipline de la gestion financière* (CDGF).[19] The AMF may exert its powers directly but in some cases it has to refer to the competent court, i.e. the *Tribunal de grande instance* de Paris or its chairman.[20]

The current insider dealing prohibition provides for the application of both criminal and administrative sanctions. The rules governing the insider dealing prohibition can be found in the Monetary and Financial Code (*Code monétaire et financier*, hereinafter referred to as MFC) and the AMF General Regulation issued by the AMF on the basis of the entitlement given in Article L.621-6 of the MFC and published in the Official Journal of the French Republic following approval by the order of the Minister of Economy.

II Luxembourg

The Luxembourg Stock Exchange started to operate on 6 May 1929. Since the very beginning, it concentrated on listing of the bonds. Thus, although in terms of capitalisation the Luxembourg Stock Exchange was in 2006 only thirteenth in

[14] TRUSZKOWSKI, Jacek, *Euronext,* in: in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 57.

[15] JEANDIDIER, Wilfrid, *Droit pénal des affaires*, Dalloz, 5th edition, 2003, p. 66.

[16] In the case TGS, for more details see: section "Texas Gulf Sulphur Co.", Chap. 1.

[17] MFC, Article L.621-1.

[18] Act of Parliament No. 2003-706 of 1 August 2003 on the financial security, Chapter 1.

[19] TRUSZKOWSKI, Jacek, *Euronext*, in: in: Ziarko-Siwek, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 49.

[20] E.g. MFC, Article L.621-13.

Europe, its role in the world economy cannot be overestimated. About 60% of debt securities in Europe are listed in Luxembourg. The other important groups of the financial instruments that can be found there are undertakings for collective investment and investment funds.[21]

The tasks of a single competent authority in Luxembourg are fulfilled by the Commission of Surveillance of the Financial Sector (*Commission de surveillance du secteur financier*, hereinafter referred to as "CSSF").[22] It superseded in 1998 the Commissariat aux Bourses.[23]

The fight against insider dealing in Luxembourg has begun with the adoption by the European Community of the Insider Dealing Directive. In consequence, the first Luxembourg anti-insider dealing regulation was adopted in 1991, as the Act of Parliament of 3 May 1991 on insider dealing.[24] The regulation transposed into national law the Insider Dealing Directive.

The replacement of the Insider Dealing Directive by the Market Abuse Directive forced the legislature to introduce a new law governing the extended scope of the fight against market abuse. It was made by the Act of Parliament of 9 May 2006 on market abuse[25] (hereinafter referred to as the "Act on Market Abuse").

The transposition of the Market Abuse Directive into Luxembourg law has been made with maximal respect for the wording of the Directive as well as for the Level 2 directives. Therefore, many articles of the Act of Parliament of 9 May 2006 just repeat the provisions of the directives. In order to facilitate the application of the new provisions of law, the CSSF issued three circulars aiming at the presentation and explanation of the notions used in the Act on Market Abuse.[26] It also referred to the CESR guidance, as a tool that may be useful in its interpretation.

It should be also noted that the initial wording of the Act on Market Abuse applied its provisions not only to the regulated markets within the meaning of Directive 2004/39/EC[27] (which means the markets that can be found on the list held by the European Commission) but also to all other markets that fulfilled the conditions equivalent to those established by that directive. Therefore, the scope

[21] GÓRA, Małgorzata, *Giełda papierów wartościowych w Luksemburgu – Luxembourg Stock Exchange*, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, pp. 375–388.

[22] Act of parliament of 23 December 1998 on creation of the Commission of Surveillance of the Financial Sector, as amended, Article 1(1).

[23] GÓRA, Małgorzata, *Giełda papierów wartościowych w Luksemburgu – Luxembourg Stock Exchange*, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 377.

[24] Published in *Mémorial* A n° 31 of 24 May 1991.

[25] Published in *Mémorial* A n° 83 of 16 May 2006, it may be also noted that the transposition of the Market Abuse Directive to the national law was made after the delay provided by the directive, after the judgment of the CJEU in case C-151/06 stating the non-respect of the due date of implementation.

[26] CSSF circular 06/257, 07/280 and 07/323.

[27] OJ L 145, 30.4.2004, pp. 1–44, as amended (the so-called MiFiD Directive).

of application of the Luxembourg regulation was much wider than in the other Member States: it might be applied to the financial instruments that were admitted to negotiation on a Japanese or American stock exchange, if they only complied with the above-mentioned conditions. Such a formulation was caused by the international character of the Luxembourg stock exchange and envisaged problems with application of different rules on a basis of the geographical position of the market.[28]

Meanwhile, the application of this provision was in practice very difficult for the CSSF. It had to evaluate *ad hoc* the compliance with the provisions of Directive 2004/39/EC of different markets.[29] For that reason, the amendment of the act changed the wording of this rule and currently the notion of regulated market is applied, besides the markets that may be found on the list held by the European Commission, to the markets where the provisions and prohibitions in domain of the market abuse are similar to the ones established by the Act on Market Abuse.[30] In consequence, the CSSF is not obliged to verify the foundations of a market but only the existence of insider dealing and market manipulation prohibition.

III England and Wales

The analysis of the implementation of the Market Abuse Directive into the British legal system is interesting for at least two reasons. First of all, the legal system in England and Wales is based on common law. The number of acts of parliament, although on the rise, is still lower than in civil law countries, and an important role is played by the courts and the judgments their pass.[31] Secondly, Great Britain is one of the most developed countries in the world and its financial market is the biggest in the Europe. Its crucial element, i.e. the London Stock Exchange is widely acknowledged as one of the most transparent, best regulated and most effective stock exchange markets in the world.[32] Moreover, when the value of the listed

[28] Project of the law No. 6081 of the Luxembourg Parliament, Ordinary session 2009–2010, pp. 4–5.

[29] Project of the law No. 6081 of the Luxembourg Parliament, Ordinary session 2009–2010, p. 5.

[30] Act of Parliament of 26 July 2010 amending the law of 9 May 2006 on market abuse and complementing the transposition of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (published in Mémorial A No. 119 of 28 July 2010, pp. 2046-2047), Article 1.

[31] ALEXANDER, Larry, SHERWIN, Emily, *Judges as Rule Makers*, in: Common Law Theory, Ed. Edlin, Douglas E., Cambridge University Press, 2007, pp. 27–50.

[32] PIEKARZEWSKA, Agnieszka, *Giełda papierów wartościowych w Wielkiej Brytani – London Stock Exchang*e, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 23.

assets is analysed, it is the second in the world just after the New York Stock Exchange.[33]

Because there are small differences in regulation of insider dealing between the different parts of the United Kingdom, the rest of the chapter will refer to the regulation binding in England and Wales.

The English insider dealing regulation may be found in two acts: the Financial Services and Markets Act 2000 (hereinafter referred to as "FSMA 2000") and Criminal Justice Act 1993 (hereinafter referred to as "CJA 1993").

The prohibition of insider dealing has been present in the FSMA 2000 since its enactment in 2000. However, the adoption of the Market Abuse Directive forced the English legislature to introduce into the act some changes in order to implement the Market Abuse Directive and make the English regulation more complying with the other European Member States. The amendments were introduced in 2005 by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005. The initial wording of the prohibition did not contain the notion of "insider dealing" and was coping only with a general notion of "market abuse". Meanwhile, the amendment introduced in 2005 implemented the provisions of the Market Abuse Directive and made distinctions between the insider deals and market manipulation.

The FSMA 2000 creates a legal basis for the financial market operations. It designates the Financial Services Authority (hereinafter referred to as "FSA") as an administrative entity responsible for the proper fulfilment of the obligations imposed on the market participants.

The analysis of the English stock exchange market and of the activity of its administrative authority is very interesting for one more reason. Recently the FSA launched a strong campaign that aimed at a significant increase in insider dealing detection and prosecution. One of the elements of this campaign is that, from March 2009, all entities supervised by the FSA have to record all telephone conversations and electronic communications that relate to client orders and to the conclusion of transactions in the financial instruments. These records have to be kept for 6 months.[34] Moreover, the FSA has recently proposed to introduce an obligation to register all mobile phone conversations of employees of banks and financial companies.[35] The introduction of this surveillance system would cost about GBP 18 million and then annually about GBP 16 million to maintain. Moreover, the FSA's proposition includes the obligation imposed on the companies to assure that the employees do not use their private phones (that cannot be supervised and

[33] PIEKARZEWSKA, Agnieszka, *Giełda papierów wartościowych w Wielkiej Brytani – London Stock Exchange*, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 41.

[34] The FSA's markets regulatory agenda, May 2010, p. 42, obligation was imposed by enactment of a new section of FSA Handbook, i.e. Section COBS 11.8 published in Policy Statement 08/01 of March 2008, available at http://www.fsa.gov.uk/pubs/policy/ps08_01.pdf (last seen on 15 February 2011).

[35] The FSA's markets regulatory agenda, May 2010, p. 42.

registered) in order to transfer the sensitive data.[36] So far this is only a non-binding proposition but it shows how far the British competent authority wants to reach in order to detect insider dealing.

It should be also noted that (according to the English legal tradition) the penalty imposed by the FSA on the basis of the FSMA 2000 is considered civil, in spite of the fact that such penalty is imposed following a proceeding before the administrative authority, by the same authority acting on its own discretion, with no court participation. Therefore, in order to keep some consistency with the "continental" approach, it will be considered as being "administrative" and not "civil".

IV Poland

Activity of the stock exchange is incompatible with the principles of the communist system and centrally-planned economy. Thus, till 1989, when Poland was under the totalitarian reign, a stock exchange market could not exist.[37] Then, alongside with the democratic changes, the creation of a stock exchange market took place. Its foundation had to be preceded by the enactment of the proper legislative acts. The operational schema was elaborated with the help of France.[38] Eventually, the first Polish stock exchange started to operate in April 1991.[39]

The Polish example shows that not all Member States have a long tradition of fight with market abuse. In some of them, because of historical reasons, both regulations of the whole stock exchange and the markets themselves are very new. The Member States that joined the European Union in 2004 and afterwards have had no possibility to develop their stock exchange markets during nearly 50 years. It should be underlined that it was the period of time when the wrongfulness of insider dealing was recognised on many stock exchange markets. In consequence, not only did market players have to learn about the proper investments but also competent authorities had to learn how to punish market abusing behaviour.

The administrative authority that supervises the Warsaw Stock Exchange is the Commission of Financial Supervision (*Komisja Nadzoru Finansowego*, hereinafter

[36] Information transmitted by Reuters on 18 March 2010 available at http://www.iii.co.uk/news/?type=reutersnews&articleid=TRE62H41O&feed=Bus&action=article (last seen on 15 February 2011).

[37] Historia giełdy w Polsce, available at http://www.gpw.pl/historia (last seen on 15 February 2011).

[38] Historia giełdy w Polsce, available at http://www.gpw.pl/historia (last seen on 15 February 2011).

[39] Historia giełdy w Polsce, available at http://www.gpw.pl/historia (last seen on 15 February 2011).

referred to as "KNF").[40] This entity superseded the Commission of Securities and Stock Exchanges (*Komisja Papierów Wartościowych i Giełd)* that had been supervising the Warsaw Stock Exchange since its beginnings in 1991.[41]

From the European perspective, the Warsaw Stock Exchange is a medium European stock exchange in terms of capitalisation.[42] It is the biggest of the stock exchanges of the new Member States,[43] but still relatively small comparing to the "old" European financial markets.

The regulation and prohibition of insider dealing in Poland exists since 13 February 1994.[44] It was introduced 3 years after the inauguration of the Warsaw Stock Exchange. The objective of such early introduction was to attract foreign investors and present the will to combat any behaviour that would impair fair competition on the national stock market.[45] Since then, in spite of the rather numerous amendments introduced to the Polish stock exchange system, the prohibition of insider dealing has always been present.

The current system that aims at implementation of the Market Abuse Directive can be found in the set of three acts of parliament of 29 July 2005.[46] The transposition to the Polish law was mostly made by implementation of the wording of the Directive; therefore, the same problems of interpretation as with the Market Abuse Directive may occur. However, there are some differences between the Polish regulation and Market Abuse Directive that will be presented in the next sections of this chapter.

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[40] Act of Parliament of 21 July 2006 on Financial Market Supervision, Article 3.2.

[41] Act of parliament of 22 March 1991 – The Law on the Public Trading of Securities and Trust Funds, Article 6.1.

[42] ZIARKO-SIWEK, Urszula, *Giełda papierów wartościowych w Polsce – Giełda Papierów Wartościowych w Warszawie SA*, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 367.

[43] i.e. those who joined the European Union in 2004 and later, ZIARKO-SIWEK, Urszula, *Giełda papierów wartościowych w Polsce – Giełda Papierów Wartościowych w Warszawie SA*, in: ZIARKO-SIWEK, Urszula (editor), Giełdy kapitałowe w Europie, Warsaw 2007, p. 367.

[44] Entry into force of the Act of Parliament of 29 December 1993 Amending the Act of Parliament of 22 March 1991 on Public Trading in Securities and Trust Funds (Dz. U. 1994, No. 4, item 17, as amended), Article 1. 36–37.

[45] MROWIEC, Zbigniew, *Komentarz do Dyrektywy Rady Wspólot Europejskich z 13 listopada 1989 (89/592/EWG),*in: Prawo Wspólnot Europejskich a prawo polskie. T. 1, 1996, p. 242.

[46] Act of Parliament on Capital Market Supervision (Dz.U. 2005, No. 183, item 1537, as amended), Act of Parliament on Trading in Financial Instruments (Dz.U. 2005, No. 183 item 1538, as amended), Act of Parliament on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies (Dz.U. 2005, No. 183, item 1539, as amended).

C Main Notions of the Market Abuse Directive and Their Transposition into National Systems

As it was presented in the first chapter, the notion of insider dealing is composed of a few basic elements. The most important of them are inside information, insiders, forbidden behaviours and the nature of applied penalties. Their analysis is necessary in order to examine the applicability of the criminal and administrative law to insider dealing. Thus, the objective of this part is to verify whether the wording of the Directive, its scope and the intentions of its authors were respected and the transposition into national systems let create a uniform European system of fight against insider dealing.

I Inside Information

The notion of inside information is essential for the proper formulation of the insider dealing prohibition. As it was presented in Chapter 1, the definition introduced by the Directive, even after the additional explanation given in the Level 2 and 3 acts, is not perfect and may potentially provoke some doubts and possible disparities between the Member States. Thus, every Member State had to face the difficulties arising from its implementation.

1 France

The French insider dealing regulation contains two distinct definitions of inside information. One can be found in the AMF General Regulation and refers to the administrative prohibition and punishment of insider dealing.[47] The second was enacted for the criminal prosecution purposes and is located in the MFC.[48]

The formulation of the "administrative" inside information definition repeats the provisions of the Market Abuse Directive and Directive 2003/124/EC. It does not develop its provisions or add new ones to it. Meanwhile, the definition elaborated for the purposes of the criminal law differs from its "administrative law" equivalent. The criminal sanctions may be applied towards the inside (or, according to the French nomenclature, privileged) information concerning the prospects or the situation of an issuer whose securities are admitted to trading on a regulated market or the likely performance of a financial instrument admitted to trading on a regulated market.[49] The criminal law regulation does not develop the notion of

[47] General Regulation of the Financial Markets Authority (AMF), Articles 621-1–621-3.
[48] MFC, Article L.465-1.
[49] MFC, Article L.465-1.

inside information. In consequence, a reference must be made to the administrative definition of the notion. However, the complementing notions make the definition used for the criminal law purposes narrower. That means that all prerequisites of administrative law definition have to be fulfilled but, additionally, the information has to relate to current or probable future situation of an issuer or to the probable changes in value of the financial instruments. Moreover, this definition limits its application only to the financial instruments listed on regulated markets.[50]

One could inquire whether the modification introduced in the MFC changes importantly the scope of the definition. The "criminal" definition has to concern the issuer or the future changes in the value of a financial instrument. That means that only the information that relates directly to at least one of these two notions can be used as a basis for criminal prosecution. Information that just brings a message about general trends on the market or future events that do not concern a specific issuer or financial instrument cannot lead to criminal penalties, even if according to the CESR guidance it can be inside information. Thus, not always will inside information, in the meaning of administrative law, allow for the launching of the criminal procedure. That means that, in some situations, only the administrative procedure applies to a given breach.

It should be noted that the definition of inside information for the purposes of French criminal law comprises two elements. One part of the definition can be found in the MFC. However, the basic notion of privileged information is developed in an act issued by an administrative entity, i.e. in the AMF General Regulation. Although this document was published in the Official Journal and approved by an order by the Minister of Economy, its formulation is made within an administrative procedure and not by a democratically elected parliament. It is questionable whether the use of such administrative definition in the criminal proceeding is proper.

2 Luxembourg

The transposition of the inside information definition into Luxembourg law was made by a direct introduction of the definition used in the Market Abuse Directive and Directive 2003/124/EC into the national law.[51] Thus, all the presumptive problems of the interpretation of this notion mentioned in Chapter 1 also apply to Luxembourg law and it will be the task of the Luxembourg courts as well as that of the administrative authority, to develop the proper understanding of the notions used in the definition that can be found in the Act on market abuse.

[50] The Market Abuse Directive extends its application also to financial instruments that are not admitted to trading on a regulated market in a Member State, if only their value depends on a financial instrument that is admitted to trading on a such market (Article 9).

[51] Act on Market Abuse, Article 1 .1 and Article 2.

3 England and Wales

As in France, English law provides two definitions of inside information. The FSMA 2000 contains a definition that repeats almost all the provisions of the Market Abuse Directive and of Directive 2003/124/EC.[52] However, in one aspect, the notion has been importantly modified. The FSMA 2000 does not require that information should "not have been made public". Instead, it qualifies as inside information the information that "is not generally available".[53] The change, although seemingly small, is not insignificant. "Making information public" refers to an action that in a precise way allows one to verify when information was disclosed. Meanwhile, information may be "generally available" without its public disclosure made in an official way. Thus, it may be in some cases difficult to decide when it lost its character of "inside information". On the other hand, such a definition takes into consideration the situations when information becomes available for the market participants without making it public, e.g. without being officially disclosed by the entity it relates to. It may happen when another disclosed piece of information makes it possible to guess the content of the inside information or simply when information becomes available because of the imprudent behaviour of one of the insiders without the issuance of an official statement by the holder of information.

The second definition of inside information, enacted for criminal law purposes, can be found in the CJA 1993.[54] It was elaborated after the introduction of the Insider Dealing Directive and refers to the superseded Company Securities (Insider Dealing) Act 1985.[55] This definition differs importantly from the administrative law description of inside information. Like in the case of the FSMA 2000, information, in order to be considered as inside information, should not have been made public and its disclosure should be likely to have a significant effect on the price of the securities. However, it has to relate to particular financial instruments or to a particular issuer of financial instruments or to particular issuers of financial instruments and not to financial instruments generally or to issuers of securities generally. Meanwhile, the Market Abuse Directive applies the notion of inside information to information that relates (directly or indirectly) to one or more issuers of financial instruments or to one or more financial instruments.[56] In consequence, the CJA 1993's definition is narrower. The notion of information in the market Abuse Directive may be used as regards practically all price-sensitive information that relates to the market. The CJA 1993 creates the following limitation: that

[52] FSMA 2000 modified by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, Section 118C.

[53] FSMA 2000, Section 118C(2)(a).

[54] CJA 1993, Section 56.

[55] WOTHERSPOON, Keith, *Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993*, The Modern Law Review, May 1994, Vol. 57, No. 3, p. 420.

[56] Market Abuse Directive, Article 1.1.

information has to relate to concrete issuers or financial markets. Obviously it makes it more precise and enables establishment of its exact content for the prosecution purposes.

The second difference between the Directive and the CJA 1993 relates to their respective scope. According to the CJA 1993, inside information should be specific or precise, while the Market Abuse Directive only requires it to be precise. The objective of this formulation of the English criminal law act was to enable the prosecution of the information that has a specific content (e.g. relating to the better than expected financial results of an issuer) but is not precise, i.e. it is not exact and does not contain any details.[57] Meanwhile, the notion of being precise should be construed according to Directive 2003/124/EC. It defines being "precise" as indicating a set of circumstances that are specific enough to draw a conclusion about the possible consequences.[58] This understanding of the word "precise" is far from the usual meaning of this word in everyday speech and in fact includes both notions present in the CJA 1993 definition, i.e. precision and specificity. As a result, the main difference between both definitions consists in the possible relation of information in relation to an imprecise number of issuers of financial instruments or an imprecise number of financial instruments.

Another interesting issue arises from the notion of "making information public". The CJA 1993 has its own definition and provides the list of circumstances in which information is or may be considered to be public. Thus, information is made public not only when it is published in accordance with the rules of a regulated market for the purpose of informing investors and their professional advisers, but also when it is contained in records that, by virtue of any enactments, are open to inspection by the public or if it can be readily acquired by persons likely to deal in any financial instruments to which the information relates, or created by an issuer to which the information relates. Besides, information is made public when it is derived from information which has been made public.[59] Moreover, information may be treated as made public in situations when only persons exercising diligence and expertise can acquire it or when it is communicated to a section of the public and not to the public at large or when it can be acquired only by observation or when it is communicated only on payment of a fee. The last possibility provided by the act relates to the publication only outside the United Kingdom.[60] It should be also noted that these provisions contain many imprecise notions. For example, how to decide that a section of the public is big enough? How should the information be published outside the United Kingdom? Should it be processed according to the rules governing the foreign market on which the disclosure takes place? An opinion could be defended that it would be enough if it was published in any way. According

[57] WOTHERSPOON, Keith, *Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993*, The Modern Law Review, May 1994, Vol. 57, No. 3, p. 421.

[58] Directive 2003/124/EC, Article 1.1.

[59] CJA 1993, Section 58(2).

[60] CJA 1993, Section 58(3).

to the view expressed by the Economic Secretary during the elaboration of the CJA 1993, a publication in a well-known foreign newspaper could be qualified as publication of information. However, the opposite conclusion could be drawn if the publication took place in a regional or local newspaper.[61] Thus, there is still a lot of room for the judiciary interpretation of the circumstances of an alleged breach.

4 Poland

The Polish law provides one definition of inside information.[62] Unsurprisingly, it is based on the wording of the Market Abuse Directive. Unfortunately, the analysis of the Polish version of the inside information definition that can be found in the Directive may provoke in some aspects doubts. Its exact wording applies to the information that refers to one or few financial instruments or issuers of financial instruments. It uses the Polish word "kilku" or "kilka" which literally means "few" and presupposes a small number of concerned items.[63] Meanwhile, other versions, e.g. English or French, do not use the words that would limit the number of objects to which the information should relate. The application of this formulation by the Polish legislature seems to be obvious; it relies on a Polish version of the Market Abuse Directive published in the European Communities Official Journal. It should be observed that the formulation that can be found in the Polish version of the Directive is evidently incorrect and should be amended.

Interestingly, the Polish legislature, while transposing the Market Abuse Directive into the national legal system, decided to introduce a modification to the wording of its Polish version and used the word "precise"[64] instead of the wording proposed by the translators, i.e. "precisely defined character."[65] A question can be asked on why the translation for the purposes of the Official Journal was made so negligently that it reversed some part of the meaning of the Directive and used unclear formulas instead of the Polish equivalent of the word "precise", applied in the Directive.[66] And, on the other hand, it is not clear why the Polish legislature was

[61] WOTHERSPOON, Keith, *Insider Dealing: The New Law: Part V of the Criminal Justice Act 1993*, The Modern Law Review, May 1994, Vol. 57, No. 3, pp. 423–424.

[62] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 154.1.

[63] Market Abuse Directive, Article 1.1, Polish version published in OJ Special edition in Polish: Chapter 6 Vol. 4 pp. 367–376, p. 371.

[64] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 154.1, author's translation into English.

[65] Market Abuse Directive, Article 1.1., Polish version published in OJ Special edition in Polish: Chapter 6 Vol. 4 p. 371, author's translation into English.

[66] Especially, when this change in formulation does not bring any clarification on the understanding of the notion of "being precise".

not more determined and amended only the part referring to precision of information and not to the number of concerned issuers or financial instruments.

The limitation of the number of entities to which the provisions applies may provoke the same questions that were presented in the analysis of the English CJA 1993.[67] However, the English criminal text does not aspire to implement the Market Abuse Directive into English law. Meanwhile, in order to properly apply the Polish regulation a reference to the Directive has to be made.[68] And, according to the CJEU case-law,[69] it should be read in order to keep a maximal conformity to the will of the European legislature. That means that the Polish word meaning "few" should be extended in order to allow the rule to be applied even in case of a much bigger number of concerned items. On the other hand, a question should be asked on whether such extensive interpretation could be applied. The Polish insider dealing regulation is based on criminal law prosecution. The criminal law has to be precise and its interpretation cannot extend it. Therefore, the Polish legislature should imperatively amend the definition. Otherwise, it either risks being alleged not to respect the provisions of the Market Abuse Directive or it must violate the principles of proper application of criminal law.

II Insiders

The proper functioning of the insider dealing regulation cannot exist without a precise definition of persons whose actions could be qualified as breaching the prohibition. The Directive extends the notion of insiders to almost all persons in possession of inside information. Thus, the Member States, while transposing the Market Abuse Directive had to determine wisely the scope of the persons to which the rules apply.

1 France

The definition of insiders that can be found in the AMF General Regulation enumerates the same categories of persons as the Market Abuse Directive.[70] The only difference concerns the persons who have access to inside information through the exercise of their employment. The French definition not only mentions those who have access to the information through the exercise of their employment, profession or duties but also adds a category of persons who enter into possession of

[67] See Sect. C.I.3 above.

[68] In this case not only to the Directive published in the Polish Official Journal but to the other languages versions.

[69] E.g. CJEU, 14 February 1994, *Paola Faccini Dori against Recreb Srl*, C-91/92.

[70] AMF General Regulation, Article 622-2.

inside information because of their participation in the preparation or execution of a corporate finance transaction.[71] In fact, such persons would be obliged anyway to abstain from dealing, communicating or recommending on a basis of such information as the persons who hold inside information and know, or should know about its character (i.e. as secondary insiders).[72] However, the creation of a new category of primary insiders means that the AMF is no longer obliged to prove their knowledge about the fact that information they possessed and used fulfils the requirements to be called inside information. It makes the imposition of penalties much easier.

As for the notion of inside information, the scope of the persons to whom the criminal prohibition of insider dealing may be applied is defined in a different way than in the administrative regulation.[73] Although the main division between primary insiders and secondary insiders is applied, the content of these notions uses other criteria. The group of primary insiders is composed of the executives of a company referred to in the French Commercial Code. These are the chairman, managing directors and directors of a company, any natural persons or legal persons exercising the functions of a director or member of the supervisory board, and also permanent representatives of legal persons exercising said functions.[74] Moreover, the definition of "insider" includes the persons who obtain privileged information through the practice of their profession or the performance of their functions. The wording of these provisions means that these persons may work for the concerned issuer as well as in external companies rendering different services to the company in question, e.g. as lawyers or accountants but also waiters who overheard conversation while serving lunch.

Secondary insiders for the purposes of criminal law are defined as those who were not mentioned as primary insiders and who knowingly (or with full knowledge of facts) obtain privileged information. This definition, and especially the fact that information has to be obtained "knowingly", refer to the wording of the Insider Dealing Directive but does not apply its additional requirement concerning the source of information. Thus, the prosecution is obliged to prove that the recipient of information knew about its special character but not the fact that information was acquired from an insider.

2 Luxembourg

In Luxembourg law there is just one definition of an insider. The Luxembourg legislature, in order to transpose this notion into national law, decided to introduce into the national regulation the exact wording of the Market Abuse Directive.[75]

[71] AMF General Regulation, Article 622-2, first paragraph, point 3.

[72] AMF General Regulation, Article 622-2, third paragraph.

[73] MFC, Article L.465-1.

[74] French Commercial Code, Article L.225-109.

[75] Act on Market Abuse, Articles 8 and 10.

Naturally, in such a situation, the state cannot be blamed for misinterpreting the wording of the Directive. However, all the possible doubts that arise from analysis of this definition may emerge in practice at a national level.

3 England and Wales

In the English and Welsh legal systems, two distinct definitions of "insider" coexist. The older one was enacted for the purposes of the criminal law and can be found in the CJA 1993.[76] According to this definition, an insider is a person who has inside information only if he knows that it is inside information, if this information was acquired from an inside source and if the alleged insider knows about its origin. Additionally, the acquisition from internal source takes place only if the information was obtained through being a director, employee or shareholder of an issuer of financial instruments or through having access to the information by virtue of the employment, office or profession or if the information is acquired directly or indirectly from any of the persons mentioned above.

The second definition of "insider", elaborated for the needs of administrative regulation of insider dealing, can be found in the FSMA 2000.[77] It is based on the Market Abuse Directive and repeats generally its provisions. The only difference introduced by the English legislature relates to the notion of a secondary insider. The original wording of the Directive mentions a person who possesses inside information while that person knows, or ought to have known, that it is inside information.[78] Meanwhile, the FSMA 2000 defines the secondary insider as any person who has inside information which he has obtained by means other than primary insiders and which he knows, or could reasonably be expected to know, is inside information.[79] As the description of the primary insiders does not differ from the wording of the Market Abuse Directive, it may be presumed that the modification to the notion of secondary insider was intentionally made by the English legislature. The English version of the definition seems to be slightly more in favour of an alleged wrongdoer. It does not presume an obligation of knowledge about the fact that possessed information is inside information. But it underlines the importance of circumstances under which common sense indicates that one has inside information. It is difficult to say whether this change of the definition of "insider dealing" will actually influence the application of insider dealing prohibition to secondary insiders comparing to the other Member States. The difference it brings to the Directive is very small, but the FSA practice should show its real impact.

[76] CJA 1993, Section 57.

[77] FSMA 2000 modified by the FSMA 2000 (Market Abuse) Regulations 2005, Section 118B.

[78] Market Abuse Directive, Article 4.

[79] FSMA 2000 modified by the FSMA 2000 (Market Abuse) Regulations 2005, Section 118B(e).

4 Poland

The insider's definition that was transposed into Polish law includes all the elements of the definition that can be found in the Market Abuse Directive. However, the Polish legislature decided to introduce an independent systematisation of the notion. Thus, in the Polish regulation, three kinds of insiders may be found.

In the first group, there are those persons who gain inside information by virtue of membership of the governing bodies of the company, by virtue of their holding in the capital of the company (like in the Market Abuse Directive, there is not minimal threshold for shareholders), or as a result of having access to inside information through their employment or practised profession.[80] The regulation includes a non-exhaustive list of possible insiders that belong to this group. It mentions, e.g. members of the management board, qualified auditors, persons employed or holding posts in the governing bodies in the subsidiary or parent entity of the issuer and brokers or advisers. The second group is composed of persons who enter into possession of inside information through criminal activities.[81] Finally, the third group consists of the secondary insiders in the meaning of the Market Abuse Directive. In this group can be found any person that learned about inside information in a manner other than described in the first and second group and who knows or, when acting with due diligence, could know that it is inside information.[82]

A question may be asked on why the Polish legislature decided to divide the primary insiders into the two groups mentioned above. The probable explanation is that, in this way, it distinguished two different ways of entering into possession of information. In the first group, transfer of information is made on the basis of a contractual relation between an insider and the relevant entity. Meanwhile, the insiders of the second group obtain inside information through criminal behaviour. There is no breach of contract but rather a theft, or any other criminal activity, that let them learn about it.

In spite of the legislature's efforts to make the distinction clearer and more logical, it should be noted that the formulation of the second group of insiders seems to be made improperly. The objective of the Market Abuse Directive was to punish not only those who get inside information on the occasion of the committing an offence but also those whose wrongful behaviour may constitute inside information (as information about planned attacks on the World Trade Center might influence the price of the shares in the insurance companies and could had been used in order to make profits on the decrease of the value of the financial

[80] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.1.1.

[81] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.1.2.

[82] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.1.3.

instruments issued by the insurance or aviation companies). Thus, the wording of the Market Abuse Directive applies to both possible situations when there is a link between the criminal behaviour and inside information. Meanwhile, the Polish regulation takes into account only information acquired through criminal activity. That means that someone who steals documents and deals on the stock exchange on their basis would be punished for stealing and insider dealing. However, if someone plans a wrongful activity that would influence the value of given issuer's shares and deals in these financial instruments in advance, prosecution would be possible only for attempt at, or accomplishment of, the main wrongful act.[83]

The definition of secondary insiders that can be found in the Polish law also requires further attention. As it was mentioned above, the secondary insider is someone who knows or, when acting with due diligence, could have known that information he possesses is inside information. Meanwhile, the Directive describes a secondary insider as a person who knows or ought to have known that it is inside information. As it is the case in the English regulation[84] the difference seems to be small. However, introduction of a new notion, in this case "action with a due diligence", provokes new difficulties with its interpretation. While analysing one's behaviour, the prosecution will have to establish the level of proper conduct and due diligence. The regulation does not give any indications. It will be the practical application of this provision that will decide how these provisions should be understood. Thus, before that, one can only try to guess the exact scope of this definition.

III Forbidden Practices

When the notions of inside information (i.e. the object) and an insider (i.e. an actor) are defined, a special attention should be paid to the behaviours (or acts) that violate the insider dealing prohibition. Generally speaking, the Market Abuse Directive distinguishes three forbidden acts, i.e. using information by acquiring or disposing of financial instruments, disclosing it and making recommendation on this basis.[85] In all examined legal systems, these three elements can be found. Unfortunately, a more extensive analysis of provisions of the national legal systems shows numerous disparities between them.

[83] One may discuss whether in such situation the prohibition against market manipulation can be applied to the dealing in the financial instruments. However in many cases the change in value of shares might be just a "side-effect" and not the objective of an action, and that would make the market manipulation charge unfounded.

[84] See Sect. C.II.3 above.

[85] For a more detailed presentation see section "Forbidden Practices", Chap. 1.

1 France

The coexistence of two legal systems that regulate insider dealing in France results in the presence of two definitions of the forbidden acts that constitute insider dealing.

The administrative regulation is based on the wording of the Market Abuse Directive.[86] Thus, it distinguishes three main kinds of the forbidden behaviour. However, in each of these elements, subtle changes have been introduced.

The basic definition of insider dealing, i.e. that relating to the acquisition and disposal of financial instruments, applies not only to the financial instruments to which the inside information relates (as the Market Abuse Directive does) but also imposes the same prohibition to the financial instruments that are based on the financial instruments to which the inside information relates.[87] In consequence, the scope of the prohibition is much wider than in the Market Abuse Directive. It may be said that the impact of inside information is French law is much bigger and more attention is paid to the relations between the financial instruments.

When it comes to the prohibition of selective disclosure, the French regulation contains one additional exception that cannot be found in the Market Abuse Directive. The Directive allows disclosing inside information if it is made in the normal course of employment, profession or duties.[88] Meanwhile, the AMF General Regulation provides a rule that the disclosure should not be made "*for a purpose other than that for which the information was disclosed to [insiders]*"[89] The meaning of this rule is quite obscure. An insider may disclose inside information if such a disclosure enters into the scope of his duties and for that reason the information was presented to him. This rule seems to repeat the provisions that allow for the disclosure of information in the normal course of duties. However, it may be also understood as protecting the insider who is not linked by any contractual obligation to the source of information and who discloses the information to a person he was told to. In such a case he may act in good faith as a messenger and should not be punished for insider dealing. However, a question may be asked on whether such person should be punished for insider dealing even if such special clause was not provided by the national regulation. This situation assumes the ignorance of the disclosing insider. And in such situation he would be treated more as a tool used by a person who told him to disclose the information and not as an active disclosing insider.

The third forbidden behaviour, namely making recommendations, contains the same additional provision as the first one. Thus, prohibition of advising another person to buy or sell given financial instruments applies not only to the ones directly

[86] AMF General Regulations, Article 622-1.

[87] AMF, General Regulation, Article 622-1, section 1.

[88] Market Abuse Directive, Article 3(a).

[89] AMF General Regulation, Article 622-1, section 2.

concerned by the inside information but also to the financial instruments that are related to them.[90]

The criminal law regulation of insider dealing uses definitions of forbidden behaviours that differ from the administrative one. It distinguishes two kinds of wrongful acts. First, insiders are not allowed to carry out or facilitate one or more transactions before the public has knowledge of that information.[91] Although the regulation does not formulate it precisely, these transactions have to relate to the inside information and concerned financial instruments. Otherwise, the scope of this prohibition would be extended *ad absurdum*. The law provides a small distinction in wording depending on who deals while in possession of inside information. Primary insiders are not allowed to conduct or allow conducting one or more transactions directly or through an intermediary, before the public knows the inside information in question.[92] Meanwhile, the secondary insiders should not conduct or allow others to conduct a transaction directly or indirectly, before the public knows the inside information.[93] A question might be asked on whether two different formulations of the prohibition relating to the way how the wrongful act can be committed (through an intermediary and indirectly) is a simple omission of the legislature or if it was introduced to the regulation deliberately. The general rule of proper legislation requires that the same objects should be described in the same words within the same legal system (or at least within one act).[94] The presumed rationality of the legislature encourages looking for a justification for the differences in meaning between these two phrases. But probably, there cannot be found any. And the principle of strict interpretation of criminal provisions requires that the narrower scope of the prohibition that arises from a direct understanding of the notion should be applied.

The other prohibition provided by the AMF General Regulation that applies to primary insiders concerns the communication of inside information to a third party outside the normal framework of profession or functions of the insider.[95] Thus, similarly as in the Market Abuse Directive, disclosing of inside information is forbidden. However, the criminal regulation does not mention making recommendations on a basis of inside information. This behaviour is forbidden only by the administrative AMF General Regulations. The wording of the

[90] AMF General Regulation, Article 622-1, section 3.

[91] MCF, Article L.465-1 I.

[92] "de réaliser ou de permettre de réaliser, soit directement, soit par personne interposée, une ou plusieurs opérations avant que le public ait connaissance de ces informations."

[93] "réaliser ou de permettre de réaliser, directement ou indirectement, une opération [. . .] avant que le public [. . .] ait connaissance [de ces informations]".

[94] See, e.g. Exhibit to Polish Regulation of the Prime Minister of 20 June 2002 concerning the „Rules of the legislative technic" *(Rozporządzenie Prezesa Rady Ministrów z dnia 20 czerwca 2002 r. w sprawie "Zasad techniki prawodawczej")* published in Dz. U. 2002, No. 100, item 908, §10.

[95] MFC, Article L.465-1 II.

prohibition for the secondary insiders is slightly different and prohibits communicating of inside information before the public has knowledge about it. Such a formulation is a natural consequence of an approach that assumes that there is no situation when a secondary insider is entitled to disclose inside information.

Moreover, it should be noted that, in relation to the secondary insiders, the MFC provides a qualified form of the wrongful conduct. It applies when the inside information that is used (i.e. through dealing or disclosing) concerns the commission of a crime or an offence.[96] The law does not provide similar distinction for primary insiders.

The analysis of the French insider dealing regulation demonstrates that administrative and criminal law provide different descriptions of the forbidden behaviours. What is more, the administrative regulation, although based on the Market Abuse Directive, introduces small changes into the scope of the prohibition introduced by the Directive. It means that not only its scope may in practice differ from the application of the some notions in other Member States, but also criminal and administrative regulations do not apply to the same notions.

2 Luxembourg

The Luxembourg legislature was very consequent during the transposition of the Market Abuse Directive into national law. Similarly as in the cases of the definitions of inside information and insider, the wording of the relevant act of parliament in relation to forbidden behaviours repeats the provisions of the Directive in its French-language version.[97] Thus, there are three forbidden kinds of behaviour – dealing, disclosing and making recommendation and they all apply both to primary and secondary insiders. It is the only definition of the behaviour qualified as insider dealing that can be found in the Luxembourg law.

Nevertheless, the amendment that was introduced in July 2010 modified the scope of the prohibition in relation to behaviour that may be punished by application of criminal law. In order to violate the criminal prohibition one must behave "*with the will to obtain, for himself or for someone else, using any fraudulent means, any unlawful profit, even indirectly*".[98] This subjective element of one's willingness of gain of profit distinguishes then the criminal definition from the administrative law one that focuses only on an objective act of using inside information.

[96] MFC, Article L.465-1 III.

[97] Act on Market Abuse, Articles 8–10.

[98] Act of Parliament of 26 July 2010 amending the law of 9 May 2006 on market abuse and complementing the transposition of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), Article 4.

3 England and Wales

Each of the two acts that regulate the insider dealing prohibition provides its own definition of the forbidden behaviour. And although both acts use notions similar to those used in the Market Abuse Directive, none of them uses the exact wording of the Directive, nor describes precisely in the same way the scope of the forbidden behaviour.

First, the FSMA 2000 defines the forbidden behaviour as dealing or attempting to deal on a basis of inside information relating to the financial instrument in question.[99] The wording of this provision is similar to the one used in the Directive. However, the Directive forbids both dealing directly by an insider as indirectly. Meanwhile, the provisions of the English act do not mention the latter possibility.

The second behaviour that is forbidden by the English administrative regulation is disclosing inside information to another person otherwise than in the proper course of the exercise of employment, profession or duties.[100] Again, the formulation is very similar to the one applied in the Market Abuse Directive. A question might be asked on whether the notion of "proper exercise of employment" should be understood as an equivalent of the notion used in the Directive, i.e. "normal course of employment". An opinion could be defended that under some circumstances "normal" does not mean "proper". The unexpected events may force the managing persons to undertake extraordinary measures, which would be proper but not necessarily within the "normal course of duties".

Finally, the FSMA 2000 does not mention the behaviour described by the Market Abuse Directive as making recommendations. Instead, it forbids the behaviours that:

- fall outside the ones presented above and
- are based on information which is not generally available to those using the market but which, if available to a regular user of the market, would be, or would be likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected,
- and are 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.[101]

Thus, one could support the opinion that making recommendation on the basis of inside information violates this rule because such an act would fall outside the standards of behaviour expected from an insider. Nevertheless, the scope and vagueness of this rule make it a potentially very powerful tool in the hands of the national administrative authority, especially, given that in practically all cases of an

[99] FSMA 2000, Section 118(2).
[100] FSMA 2000, Section 118(3).
[101] FSMA 2000, Section 118(4).

alleged act of insider dealing it will be the competent authority's task to decide what kind of behaviour respects or not the standards.

The criminal regulation of insider dealing provides, like the Market Abuse Directive, three kinds of forbidden behaviours, namely dealing, making recommendations and disclosing the inside information. However, it uses its own wording in order to describe them and provides its own definitions and possible defences.

The offence of dealing in financial instruments is committed if an insider deals in financial instruments that are price-affected in relation to the information and, moreover, the transaction in question occurs on a regulated market and the person that deals relies on a professional intermediary or is himself acting as a professional intermediary.[102] The CJA 1993 provides also detailed definitions of the notions of "deal", "acquire", "dispose" in relation to financial instruments.[103] Moreover, it explains when one is considered to deal even if other persons conducted the transactions.[104] Thus, acquisitions or disposal of the financial instruments takes place not only when one agrees to acquire or dispose of them but also when he becomes a party to a contract which creates the financial instrument as well as when he brings to an end an agreement which created the financial instrument. Neither the Market Abuse Directive, nor the Level 2 directives provide so detailed description of these notions.

Making recommendation is defined in the CJA 1993 as a behaviour of an individual who has information as an insider and who encourages another person to deal in financial instruments that are price-affected in relation to the information, while knowing or having reasonable cause to believe that the dealing would take place in the same circumstances as described in the case of the offence of dealing, i.e. the transaction in question would occur on a regulated market and the person that deals would rely on a professional intermediary or would be himself acting as

[102] CJA 1993, Sections 53(1) and 53(3).

[103] CJA 1993, Section 55(1)–(3).

> (1) For the purposes of this Part, a person deals in securities if—
>
> (a) he acquires or disposes of the securities (whether as principal or agent); or
>
> (b) he procures, directly or indirectly, an acquisition or disposal of the securities by any other person.
>
> (2) For the purposes of this Part, "acquire", in relation to a security, includes—
>
> (a) agreeing to acquire the security; and
>
> (b) entering into a contract which creates the security.
>
> (3) For the purposes of this Part, "dispose", in relation to a security, includes—
>
> (a) agreeing to dispose of the security; and
>
> (b) bringing to an end a contract which created the security.

[104] CJA 1993, Section 55.

a professional intermediary.[105] This provision seems to comply with the Market Abuse Directive rule that prohibits inducing another person to acquire or dispose of financial instruments. However, it should be analysed whether making recommendations, encouraging or inducing someone to deal mean the same action. Making a recommendation assumes that one advises another person to deal in a particular way; it might be an acquisition or a disposal of specific financial instruments, presenting the allegedly best days for conducting the transactions, etc. In case of the encouragement, one not only gives advice but also gives his interlocutor support or courage to undertake recommended actions. Meanwhile, a person who induces someone persuades him or even causes something to happen. In consequence, if the precise meaning of each word were respected, not every recommendation might be qualified as encouragement to deal and not every encouragement might be a synonym of inducement.

The third behaviour forbidden by the CJA 1993 takes place when an individual who has information as an insider discloses this information, for other reason than in the proper performance of the functions of his employment, office or profession to another person.[106] The wording of this rule is very similar to the respective provisions of the Market Abuse Directive. However, as in the case of the administrative regulation, there is the notion of "proper" fulfilment of the insider obligations instead of the "normal" insider's behaviour. Consequently, the same doubts concerning the proper interpretation of these two notions may emerge.

The criminal regulation contains also detailed provisions that relate to the possible defences of an individual allegedly violating the insider dealing prohibition.[107] It should be noted that all these defences provided by the CJA 1993 require that the accused individual proves that his behaviour did not violate the insider dealing prohibition.[108] Thus, one accused of insider dealing by virtue of dealing in financial instruments or by virtue of encouraging another person to deal has three possible defences. He may demonstrate that he did not, at the time of making transactions, expect the dealing to result in a profit attributable to the fact that the information in question was price-sensitive information in relation to the securities, or that at the time he believed on reasonable grounds that the information had been disclosed widely enough to ensure that none of those taking part in the dealing would be prejudiced by not having the information, or that he would have done what he did even if he had not had the information. In case of disclosure of inside information, one is not guilty if he shows that that he did not at the time expect any person, because of the disclosure, to deal in financial instruments on a regulated market or that, although he had such an expectation at the time, he did not expect the dealing to result in a profit attributable to the fact that the information

[105] CJA 1993, Section 52(2)(a).

[106] CJA 1993, Section 52(2)(b).

[107] CJA 1993, Section 53.

[108] But of course it is the task of the prosecution to prove he, actually, did violate it.

was price-sensitive information in relation to the securities. These defences show that, for the English legislature, the offence of insider dealing by disclosing inside information is not wrongful *per se* but only as a contribution to another's person insider dealing. Moreover, the defences based on the expected profits demonstrate how important this element is. Meanwhile, eventual profits made by an insider are irrelevant for the Market Abuse Directive, which concentrates more on the formal element of violation of insider dealing prohibition.

4 Poland

The provisions of Polish law that define the forbidden acts of insider dealing apply uniformly to all kinds of insiders, regardless of how they learnt the information. Based on the wording of the Market Abuse Directive, the Polish regulation prohibits using of inside information as well as disclosing it and making recommendation or inducing another person on its basis to acquire or to dispose of financial instruments to which such information relates.[109] Thus, the scope of the prohibited behaviours seems to be the same as in the Directive. However, the regulation includes some additional clauses that define the notions used in the act. Thus, according to the act, the use of inside information consist in the acquisition or disposal of financial instruments for one's own account or for the account of a third party effected on the basis of inside information held by a given person, or any other legal transaction undertaken for one's own account or for the account of a third party which leads or might lead to disposal of such financial instruments.[110] It should be noted that the Polish legislature decided that the use of inside information is wrongful if deals are made on the basis of inside information. This means that the mere entering into a transaction while in possession of inside information should not violate the prohibition, as long as the inside information was not the basis of the decision to entering into said transaction.[111] It may provoke difficulties to establish a proper way how to determine whether information constituted basis for a decision. Does the decision have only one principal basis or may the basis be composed of many – even quite circumstantial – elements? Or, instead of such a speculation a reference should be made to the CJEU decision in the C-45/08 case[112] and the presumption of action based on inside information should be applied.

The disclosure of inside information was defined by the legislature as communicating to an unauthorised person, or enabling such unauthorised person to gain, or

[109] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.1-2.

[110] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.4.

[111] Similarly: ROMANOWSKA, Anna, *Informacje poufne w świetle nowych regulacji prawnych insider trading*, Przegląd Prawa Handlowego, 2006, No. 9, pp. 52–53.

[112] For more details see: section "Acquisition and Disposal of Financial Instruments", Chap. 1.

facilitating the gaining by such person of inside information.[113] Moreover, the act specifies that the offence of disclosure can be committed only in relation to one or few issuers of the financial instruments listed on a regulated market, or one or few financial instruments listed on a regulated market or acquisition or disposal of any financial instruments listed on a regulated market. Although the insider dealing prohibition, understood as dealing in financial instruments, applies to financial instruments listed on regulated market and those that are not admitted to trading on a regulated market but which price or value depends on the financial instruments listed on a regulated market, the disclosure of inside information prohibition is limited only to information that relates to financial instruments that are or sought to be admitted to trading on a regulated market. On the other hand, the disclosure itself was defined very broadly. It is not only communication of the information but also any action that facilitates the gain of inside information by others. Within the scope of this definition one should include, for example, leaving the unprotected documents in the premises where other persons have access.[114] Moreover, the prohibition of disclosure is violated even if such persons would not actually gain the information. The fact that they were able to do so is sufficient.[115]

The act of parliament enumerates some situations in which disclosure of inside information does not violate the insider dealing prohibition. The most important of them authorizes the disclosure of inside information by an insider if it is made as part of the ordinary course of his employment, the practice of his profession or the performance of his duties, provided that relevant measures have been taken to ensure that such information will be kept confidential by the persons to whom it has been disclosed.[116] The first part of this clause is based on the provisions of the Market Abuse Directive and refers to the normal disclosure of information within the scope of the one's duties. Meanwhile, the Polish legislature introduced an additional obligation for a disclosing person. It should be ensured that the recipients of the information would keep it confidential. It is not clear whether a single declaration of the information recipient would be enough or more formal steps should be taken. For evident reasons, such a declaration should be made in writing so that the "discloser" could prove his efforts to comply with the legal rules.

[113] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.5.

[114] ROMANOWSKA, Anna, *Informacje poufne w świetle nowych regulacji prawnych insider trading*, Przegląd Prawa Handlowego, 2006, No. 9, p. 53.

[115] ROMANOWSKA, Anna, *Informacje poufne w świetle nowych regulacji prawnych insider trading*, Przegląd Prawa Handlowego, 2006, No. 9, p. 53.

[116] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, published in Dz. U. 2005, No. 183, item 1538, as amended, Article 156.6.1.

IV Sanctions and Case-Law

The recital (39) of Market Abuse Directive states that "Member States should remain alert, in determining the administrative measures and sanctions, to the need to ensure a degree of uniformity of regulation from one Member State to another." Such wording presupposes a certain similarity in the systems of prosecution of the forbidden behaviour. Meanwhile, while transposing the Directive into their national systems, the Member States did not make any common arrangements. Thus, in spite of the Directive's objectives, during the transposition towards national legislations the idea of the uniformity of national sanctions was not fully realised. Analysis of the penalties applicable in different Member States demonstrates big disparities between national legislations, in spite of the fact that all of them aim at the implementation of the provisions of the same Directive.

1 France

As it was mentioned above, the insider dealing regulation in France can be found in two distinct acts and provides both administrative and criminal systems of its prosecution. Thus, naturally, each of the systems provides its own sanctions that may be applied in order to punish its violation.

a) Administrative Sanctions

The most important administrative sanction that may be imposed directly by the AMF is a financial penalty whose value may be up to EUR 1,500,000 or ten times the profit realised.[117] The other penalties that may be applied directly by the AMF are injunction to cease practice,[118] emergency temporary suspension of professional activities of regulated entities during the AMF's proceedings,[119] disciplinary sanctions against professional entities that are under the AMF's supervision.[120] Moreover, the AMF may refer to the competent court which may declare the putting in escrow of the funds, securities, certificates and rights belonging to the person being under AMF's pursuit,[121] the temporary prohibition of the professional activity or which may issue an injunction order demanding to stop the activity that does not comply with the market rules and imposing a daily penalty for every day of

[117] MFC, Article L.621–15 III.
[118] MFC, Article L.621-14I.
[119] MFC, Article L. 621–15.
[120] MFC, Article L.621–15 III.
[121] MFC, Article L.621-13.

non-respect of that order.[122] As it may be seen, the scope of the AMF's powers is very wide. Not only may the financial penalties have serious consequences for their recipient, but also all the other sanctions may paralyse his activity. The MFC provides that the amount of penalties imposed by the AMF should be adequate to the seriousness of the breaches and profits derived from them.[123] Thus, the requirement of balance between penalty and the behaviour that it sanctions is underlined by the legislature.

In the doctrine an opinion can be found that, while deciding on the penalty, the AMF has to take into account three aspects: punishment of the author of a breach, deterrence of others, and the need to restore the order of the normally functioning market.[124] This approach, by making reference to restoration of justice through punishing the author of the breach and to deterrence aspects, indicates that the administrative financial penalty plays the same role as the criminal penalty does. Finally, the latter may also have only a financial character, as imprisonment is not obligatory.[125] According to the provisions of the law, the administrative penalty punishes a wrongdoer, and this punishment is calculated on the basis of the importance of the breach, not only by depriving him of any profits he did but also by imposing an additional payment that aims at being severe in order to deter him and others, i.e. reduce any incentive of future similar act by the punished person and also to discourage others to engage into such activity. Being equipped with such important sanctioning powers, the AMF faces a high responsibility for issuing the just decisions that can have, in practice, the same effect as the judgments rendered in criminal proceeding. It should be remembered that insider dealing cases are usually very complicated. The gathered proofs in such cases are usually circumstantial and the scope of the persons that might be engaged in insider dealing is practically unlimited.

b) Criminal Sanctions

The criminal prosecution of insider dealing exists in the French system alongside with the administrative proceeding. It is regulated in the MFC. However, to the extent that it is not regulated there, the rules of the French Criminal Code and the French Criminal Proceedings Code should also be applied. The reading of both, administrative and criminal, acts shows that the scope of the criminal prohibition differs in few points from the scope of the administrative regulation. Nevertheless, in many cases the same behaviour may violate both administrative and criminal regulations.

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[122] MFC, Article .L621–14 II.

[123] MFC, Article L.621– 5 III.

[124] Ohl, Daniel, *Droit des sociétés cotées*, LexisNexis SA, 2nd edition, 2005, p. 294.

[125] See section "Criminal Sanctions" below.

According to the MFC the criminal sanctions applicable in case of the insider dealing are diversified. Different penalties may be imposed on different kinds of insiders and different kinds of breaches. Thus, primary insiders[126] who carry out or facilitate one or more transactions, either directly or indirectly, while in possession of information which is unknown to the public, are subject to the penalty of up to 2 years of imprisonment and a fine of EUR 1,500,000, which amount may be increased to the value representing up to ten times of any profit realised and shall never be less than the amount of the same profit.[127]

Meanwhile, if such an act of insider dealing is committed by a secondary insider,[128] the maximal sanctions are one year's imprisonment and, as in the administrative regulation, a fine of EUR 150,000 which amount may be increased to the value representing up to ten times of any profit realised and shall never be less than the amount of the same profit. Moreover, if the information in question relates to the commission of a crime or an offence, the sentence shall be increased to 7 years' imprisonment and a fine of EUR 1,500,000 if the amount of the profit realised is below that figure.[129]

The criminal regulation of the second form of insider dealing, i.e. disclosure of inside information, also provides different penalties for primary and secondary insiders. Those who obtain inside information through the practice of their profession or the performance of their functions (i.e. primary insiders) and disclose it to a third party outside the normal framework of their profession or functions shall incur a penalty of one year's imprisonment and a fine of EUR 150,000.[130] Although the regulation (contrary to the provisions relating to conducting transactions and establishing penalties for secondary insiders) does not contain any indication that a penalty shall be incurred only if the communication of information took place before the it had been made accessible to the public, it should be understood in a way that does not imposes penalty for distributing information that belongs to public domain. Besides, inside information after the public disclosure is not "privileged" any more.

The secondary insiders who disclose inside information before it becomes known to the public face the risk of incurring the same penalties as primary insiders, namely one year's imprisonment and a fine of EUR 150,000. However, the law

[126] As defined in the MFC, Article L.465–1 I: Executives of a company referred to in Article L. 225-109 of the Commercial Code, or persons who, through the practice of their profession or the performance of their functions, obtain privileged information concerning the prospects or the situation of an issuer whose securities are admitted to trading on a regulated market or the likely performance of a financial instrument admitted to trading on a regulated market.

[127] MFC, Article L.465 – 1 I.

[128] As defined in the MFC, Article L.465–1 III: Any person, other than those referred to in the previous two paragraphs, who knowingly obtains privileged information concerning the situation or the prospects of an issuer whose securities are admitted to trading on a regulated market or the likely performance of a financial instrument admitted to trading on a regulated market.

[129] MFC, Article L.465–1 III.

[130] MFC, Article L.465–1 II.

provides that the amount of penalty in relation to secondary insiders may be increased to the value representing up to ten times that of any profit realised and shall never be less than the amount of the same profit. Moreover, if the information in question relates to the commission of a crime or an offence, the sentence shall be increased to 7 years' imprisonment and a fine of EUR 1,500,000 if the amount of the profit realised is below that figure.[131] Surprisingly, the potential liability of secondary insiders is much more severe than the liability of a primary insider. The regulation in relation to primary insiders does not provide the additional restrictions related to the profit realised or commission of a crime or an offence.

Beside the doubts related to the uneven treatment of secondary and primary insiders, another issue arises from the formulation of the French insider dealing prohibition. The clause applicable to the use of inside information that relates to the commission of a crime or an offence provides that the financial penalty should be a fine of EUR 1,500,000 if the amount of the profit realised is below that figure. But what about a situation where the realised profit exceeds the amount indicated by the act of law? The MFC do not contain any indication on what should be the value of a penalty in case if the profit realised is bigger than EUR 1,500,000. Should the rule from the first paragraph of the same article be used by analogy and the amount of the penalty increased up to the ten times the profit realised? But the use of analogy is unacceptable in criminal law. Or shall the maximal amount be respected without regard to the value of the profit made? But in this case, why does the law contain the provision that specifies the value of the profit made?[132] Eventually, an interpretation could be defended that financial penalties can be applied only to the cases when profit did not exceed the EUR 1,500,000 threshold and are not applicable when it is above this sum. But it would be a paradox and such an interpretation seems to be too absurd to be accepted.

c) Coexistence of Criminal and Administrative Sanctions

The natural consequence of the coexistence of administrative and criminal regulations is that, in France, two systems of prosecution, criminal and administrative, coincide. In order to assure that all criminal offences are prosecuted, the MFC imposes on the AMF an obligation to notify the public prosecutor in any case when it launches administrative proceedings and finds out that the behaviour seems to violate also the criminal prohibition.[133] Although the definitions applied in the administrative and criminal regulations as well as the scope of the prohibition are not identical, in many cases both criminal prosecution and administrative proceeding and penalties may relate to a single breach. And, in both, the sanctions provided

[131] MFC, Article L.465–1 III.

[132] On this subject also: STASIAK, Fréderick, *Droit pénal des affaires*, Paris, 2009, p. 294.

[133] MFC, Article L.621 20 al. 1.

by the relevant act of law can be imposed. Thus, this system may provoke questions concerning the possible double penalties imposed for the same act in two proceedings, even if they are of a different character and have different objectives. The answer for at least some of these doubts was given by the French Constitutional Council (*Conseil constitutionnel*).[134] Although its decision, which contains some interpretative instructions, was stated on the basis of the repealed insider dealing regulation, the principles have not changed since then. AMF, like its predecessor, i.e. the *Commission des opérations de bourse*, is entitled to impose administrative penalties and, alongside the competent criminal court, may in its sentence apply the penalties provided by the MFC. The Constitutional Council first stated that the possibility for an administrative authority to impose penalties did not violate the constitutional rules if the decision was issued within the competences given by the law, the penalty did not include privation of freedom, and, during the procedure, the measures protecting the constitutional freedoms were applied.[135] Unfortunately, the Constitutional Council did not make any deeper analysis or presentation of the constitutional freedoms that should be protected and concentrated itself on the issue how the members of the administrative authority should be designated in order to declare that it assured the independence of the administrative authority and let it fulfil its powers properly.

Moreover, in the same proceeding, the Constitutional Council was asked about the potential unconstitutionality of double sanctions imposed on a basis of both administrative and criminal regulations. The Constitutional Council excluded application of the *ne bis in idem* principle to such situation.[136] However, it admitted that administrative penalties must respect Article 8 of the Declaration of the Rights of Man and of the Citizen, stating that law cannot provide penalties that are not strictly and evidently necessary. Therefore, relying on the principle of proportionality, it declared that in case of double prosecution, the total amount of the penalties imposed (i.e. the sum of the penalties imposed in both criminal and administrative proceeding) cannot exceed the highest penalty applicable for a given breach regardless of the nature of the penalties.[137] The Constitutional Council did not analyse the relation between criminal punishment by imprisonment and the administrative financial measures. Hence, a conclusion could be drawn that they cannot influence each other. On the one hand, it does not surprise. The criminal regulation provides both the penalty of imprisonment and criminal fines. On the other hand, it does not take into account the fact that the financial penalty is the only possible penalty in case of administrative punishment. In consequence, if both punishments are treated as being equal, the fact of being sentenced for imprisonment should be somehow regarded as an element of penalty for the administrative

[134] Conseil constitutionnel, decision of 28 July 1989, No. 89-260 DC.

[135] Conseil constitutionnel, decision of 28 July 1989, No. 89-260 DC, paragraph 6, see more in Sect. B, Chap. 4.

[136] Conseil constitutionnel, decision of 28 July 1989, No. 89-260 DC, paragraph 16.

[137] Conseil constitutionnel, decision of 28 July 1989, No. 89-260 DC, paragraph 27.

authority that issues a decision. Otherwise, in a hypothetical situation when someone is first sentenced in criminal proceeding for imprisonment, the administrative authority is still entitled to inflict the maximal financial penalty. In order to evaluate the Constitutional Council's decision, it should be remembered that, in practice, a criminal proceeding lasts usually longer than administrative one, and that a criminal penalty is sentenced after the imposition of an administrative one. If a judge does not find it proper to impose the penalty of imprisonment, or if he wants to impose both liberty deprivation and pecuniary penalties, he might, hypothetically, find that the sanctions already imposed in administrative proceeding limited his sentencing powers. Besides, the decision of the Constitutional Council does not take into account the different objectives of the administrative and criminal proceeding and penalties. Criminal law is concentrated on restoration of justice and protection of individual rights against their unlawful violation. A judge who is sentencing in a situation when the administrative proceeding has already finished and administrative penalties have been imposed, might be deprived of the possibility to properly fulfil his duties.

It may be also noted that the only unconstitutional rule that could be found in the previous French insider dealing regulation, and which following the decision of the Constitutional Council ceased to exist, was the regulation that let the administrative authority take part into criminal proceeding as a civil party in a case which was simultaneously treated in an administrative proceeding. In that way, administrative authority could not, in circumstances when it already issued a decision, influence criminal proceeding by asking questions, proposing new evidences, and generally using all measures accessible for civil party in a criminal proceeding.

The answer given by the Constitutional Council has not put an end to the doubt arising from the existence of the double prosecution of one act and some voices demanding the abolition of such sanctions could still be heard. They arise from the concern that criminal law should not be a universal weapon applied in every case when a need to impose sanctions emerges.[138]

The existence of the double administrative and criminal punishment, although accepted by the Constitutional Council is not widely accepted among practitioners. For that reason, a governmental proposition was made to repeal the provisions that provide for it and replace them with new ones that would lead to a single – administrative or criminal – punishment. It does not mean, however, that this project is based on a more lenient approach for insider dealing. On the contrary, the same document proposes an increase of the maximal criminal penalty to up to three, instead of two, years of imprisonment. Such a change is justified by a need of harmonisation of different criminal sanctions threatening different acts.[139]

[138] More on this discussion may be found in: COULON, Jean-Marie, *Les nouveaux champs de pénalisation, excès et lacunes*, Pouvoirs 2009/1, No. 128, pp. 7–8.

[139] *La dépénalisation de la vie des affaires,* Rapport au garde des Sceaux, ministre de la Justice, prepared by a working group chaired by Jean-Marie COULON, January 2008.

d) Judicial Decision

A long tradition of the insider dealing prohibition and the existence of both criminal and administrative sanctions resulted in France in the numerous decisions and judgments that analyse various characteristics of the regulation.[140] The following sections present a criminal judgment and an AMF decision. In both the defendants were acquitted but the reasons given by the court and the administrative authority are interesting and merits analysis.

i. Criminal Case

The criminal verdict was rendered on 13 February 2002.[141] It concerned the alleged breaches that took place in September 1999 and involved the 6-month results of the listed on a stock exchange company Aerospatiale-Matra. As each listed on a stock exchange company, Aerospatiale-Matra was bound to present to the public the documents that described its activity and gave some indications about the future results. Such a document was prepared by the relevant department and presented to audit commission composed of the members of the company's Supervisory Board. The commission introduced some changes and on 14 September addressed the document to the whole Supervisory Board that should have accepted it on 21 September. The document was qualified as confidential. Its content should have been disclosed in a specialised official journal – *Bulletin des Annonces Légales Obligatoires* – and in newspapers on 22 September. Before that day only 37 persons had an access to it.

Meanwhile, 2 days before the official announcement, on 20 September 1999, an article titled "Aerospatiale-Matra in the red" was published in "Agefi" – a daily newspaper specialised in financial markets. The article was signed by a journalist Hubert Levet. It revealed the essential data regarding the activity rapport and consolidated financial data for the last semester of the company's activity. In his publication Hubert Levet indicated that he based on an unofficial document that had not yet been accepted by the Supervisory Board. The first reaction of the market was the drop in the value of the shares in Aerospatiale-Matra of 2.5%. When the information was presented in the other specialised newspapers, the value of the company's shares decreased again for 6.10%. The president of the Board of Directors filed a complaint against an unknown person to the public prosecution.

The prosecution established that Hubert Levet was in possession of eight pages of the activity rapport that made integral part of the financial statement for the first 6 months of 1999. However, the origin of this document could not be traced.

[140] For a review of the case-law see, e.g. LOYRETTE, Sybille, *Le contentieux des abuse de marché, Procédure de sanction de l'AMF, information financière, opérations d'initiés, manipulations de cours*, Joly Editions, 2007.

[141] TGI Paris, 13 February 2002, Public Minister v. Levet, Saulnier, Jousseau and others, No. 9926669051.

The journalist admitted that he received them on 17 September but refused to indicate the source of the information. As a journalist he had a right to do so. The police could only suspect that the pages were received by fax. During the investigation it was revealed that between 14 and 18 September the journalist had numerous phone calls with Christian Saulnier who he had known for many years. Moreover, on 17 September Christian Saulnier sent by fax to Hubert Levet a document of eight pages. Christian Saulnier was a trade union member and, formally, had no access to the confidential data presented to members of the Supervisory Board. But, in the morning on 17 September he had a phone conversation with Jean-Pierre Jousseau who had officially received the documents as a representative of the employees of the company. Basing on this evidence Christian Saulnier and Jean-Pierre Jousseau were accused for disclosure of the inside information concerning the financial data of the company Aerospatiale-Matra. Moreover, Hubert Levet was accused for complicity and soliciting the inside information and Eric Dadier, who was the director of the redaction of the Agefi, was accused for handling stolen goods.

The TGI did not share the opinion of the prosecution and acquitted all accused persons. Regarding Jean-Pierre Jousseau it stated that the only proof of the Mr. Jousseau's alleged guilt that had been delivered by the prosecution was his short telephone conversation with Christian Saulnier on 17 September 1999. There were no proofs that would demonstrate transfer of the information. For that reason, the court did not found Jean-Pierre Jousseau guilty. Analysing the issue of the guilt of Christian Saulnier, the TGI observed that the scope of the criminal regulation is narrower in relation to the offence of disclosure of inside information than of making transactions on its basis. In the latter case the law requires only that information was gained by an occasion of practicing one's profession or performing one's functions.[142] Meanwhile, in the former case the information has to be obtained through the practice of the profession or the performance of one's functions.[143] For that reason, the court stated that even if it had been proved that Christian Saulnier transmitted the inside information to Huber Levet, he could not have been prosecuted for it, because he was not supposed to receive this information officially, i.e. through the practice of his profession or through performance of his functions. Moreover, the TGI stated that in spite of the unclear explanations given by Christian Saulnier and Hubert Levet regarding the content of the fax that was sent on 17 September, the investigation has not demonstrated whether the former entered into possession of the relevant inside information or whether he transmitted it to the journalist. Thus, the court acquitted him. The criminal liability of Hubert Levet who allegedly solicited inside information from his sources was derived from the fact whether he received the information from a person who entered into its possession through the practice of his possession or through

[142] *„les personnes disposant, à l'occasion de l'exercice de leur profession ou de leurs fonctions, d'informations privilégiées"*, MFC, Article L.465-1 I.

[143] *„toute personne disposant dans l'exercice de sa profession ou de ses fonctions d'une information privilégiée"*, MFC, Article L.465-1 II.

performance of his functions. As the two suspected for this act persons were declared not guilty, it was impossible to state about the possible unlawful behaviour of the source of the journalist's information. In consequence, the court had to acquit him. Finally, regarding Eric Didier, the TGI stated that his criminal liability is derived from the liability of Hubert Levet. Thus, as the latter was found not guilty, also the director of the redaction had to be acquitted. Moreover, the court noted that the charge based on handling stolen goods is unfounded because the fact of receiving inside information is regulated by special provisions of law and the provisions concerning handling material stolen objects are not applicable.

It should observed that in this proceeding the court well respected the rules governing criminal procedure and did not let base its verdict on suppositions or allegations but required from the prosecution the proofs for the charges.

What is also interesting is that if such charges were based on more solid data, i.e. a proof for transmission of the inside information was found, all these individuals would face a criminal sentence. Their names would be placed in the register of convicted persons and even maybe they would spend some time in prison. Meanwhile the inside information in this case has not been used for a personal profit but disclosed to the public, faster than provided, and led to quicker achieving by the shares of the Aerospatiale-Matra the proper prices. If the trust of the market participants to the stock exchange is the main objective of the laws that regulate it, such disclosure should not be punished but rewarded. The only breach of the confidence which may be traced in this case is violation of the obligation of confidentiality by a member of the Supervisory Board who disclosed it to the journalist. But this breach should be rather analysed from the point of view of the internal relations between the company and its members of the Supervisory Board and the intervention of public prosecution should not be necessary to handle it.

Another issue that should be examined is whether a journalist has a right to publish, i.e. disclose, inside information that he had obtained from an insider. In this case this question was not examined because the court focused on the source of information. Meanwhile, it should be underlined that even if it was stated that he obtained this information violating the law, it might be argued that disclosure of the data in a newspaper is perfectly legal. The law regulating disclosure of inside information allows such an action if it is made in the normal framework of one's profession of function. The normal framework of a journalist's work is to inform public about his findings. And the legal acts should not limit this liberty.[144]

ii. Administrative Case

This administrative law-based case moved deeply the public opinion not only in France. It involved the members of the governing body of the EADS Group, a big aviation company, as well as the companies EADS NV, Lagardère SCA and

[144] Similarly Basile ADER in: *Diffusion d'informations privilégiées non rendues publiques en matière boursière*, Légipresse, No. 194, September 2002, pp. 152–153.

Daimler AG. It was the biggest alleged insider dealing case that has been analysed by the French administrative authority.[145]

The AMF's proceeding was based on the following circumstances[146]: Since November 2005 to March 2006 members of the different governing bodies of the companies belonging to the EADS Group disposed of their shares in EADS (which was made by execution of the options they hold). Their transactions were noticed by the AMF that opened an investigation. Meanwhile, on 4 April 2006, after the market closed, the companies Lagardère SCA and Daimler AG declared that they dispose of an important part of the shares they had in EADS. The next day the market responded to this information by the decrease in value of the EADS shares of about 4.4%. Two months later, on 13 June 2006 Airbus, the company that in 80% was hold by EADS, announced that because of the industrial problems the delivery of its product – Airbus A380 – would be delayed. On the same day, EADS published a profit warning. The market reaction was immediate: during one day the price of the EADS shares fell for more than 26%.

On a basis of these facts, the AMF charged the numerous members of the governing bodies of the concerned companies as well as the companies Lagardère SCA and Daimler AG. In an administrative proceeding before the AMF's Sanctioning Commission the administrative authority accused part of them for disposing of the shares in EADS while in possession of the inside information concerning the operational results of Airbus and EADS Group provided in an operative planning for 2006-2008/2010. The second group of members of the governing bodies faced the same charges but also, additionally, they knew about the changes in the delivery programme of Airbus A380 and an important increase in the costs of development of the A350 programme. Daimler AG and Lagardère SCA allegedly were dealing in the financial instruments while they knew about the operational results of Airbus and EADS Group provided in an operative planning for 2006-2008/2010 and about an important increase in the costs of development of the A350 programme. Finally, EADS was charged with making imprecise or false statements in its public communication of 8 March 2006 regarding its 10% operating margin and provisions for the 2006 results. Additionally, EADS was charged for violation of the rules governing keeping insider information confidential as well as for abstaining for more than 2 months from disclosure to the public of the information concerning the delay in realisation of the Airbus A380 delivery programme.

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[145] MORTIER, Renaud, *Affaire EADS: mise hors de cause générale*, Droit des sociétés, No. 4, April 2010, comment 74.

[146] Decision of the AMF's Sanctioning Commission of 27 November 2009 regarding Olivier Andries, François Auque, Fabrice Bregier, Charles Champion, Henri Coupron, Ralph Crosby Jr., Thomas Enders, Alain Flourens, Noël Forgeard, Jean-Paul Gut, Gustav Humbert, Jussi Itävuori, John Leahy, Erik Pillet, Andreas Sperl, Thomas Williams, Stefan Zoller and the companies EADS NV, Lagardere SCA, and Daimler AG, published in Recueil des Décisions de la Commission des Sanctions de l'AMF et des juridictions de recours 2007-2009, available at http://www.amf-france.org/documents/general/9652_1.pdf?lang=fr&Id_Tab=0 (Last seen on 28 January 2011), pp. 741–743.

The AMF's decision of 27 November 2009 tackles numerous issues that arose during the administrative investigation and also the defences that were used by the parties that faced the risk of being sanctioned. Here, only some of them, the most pertinent from the point of view of punishment that might have been imposed on insiders shall be analysed.

First of all, the AMF had to state about its competence to deliver a decision in this case. EADS is a Dutch company and it fulfils its duties arising from the Transparency Directive[147] in the Netherlands. The AMF distinguished the scope of the application of the Market Abuse Directive and the Transparency Directive so that it enabled the administrative authority to render decision in this case. Nevertheless, it should be noticed that both directives seem to, at least partially, overlap and probably there will be similar problems in other cases that involve the companies listed on different stock exchanges.

The second important defence was based on the fact that not all gathered during the investigation data were included in the final documentation presented to the Sanctioning Commission. The Commission dismissed this argument and stated that they had no value for examination of the charges. As Jean-Jacques Daigre rightfully noted it such a declaration should not be accepted.[148] The value of all gathered evidence cannot be evaluated before the proceeding begins. Moreover, the proofs that are useless for the prosecution may be valuable for the defence. Hence, in order to assure a transparent and fair proceeding all the gathered in the investigation evidences should be presented to the sanctioning body.

The AMF's Sanctioning Commission in its analysis of the elements of the charges had to delimit the inside information from information that are not covered by the insider dealing prohibition. First, it attempted to determine whether the operational results of Airbus and EADS Group provided in an operative planning for 2006-2008/2010 might be treated as inside information. It observed that this kind of estimations was based on very prudent assumptions and they were supposed to be revised every year so that they could be more reliable. Moreover, the Sanctioning Commission underlined that the generality of these estimations made them similar to those elaborated by the market analysts who based on generally available data. On this basis it stated that the planning was not inside information that could be useful for a market investor. Therefore, the charges based on use of this data had to be dropped.

Regarding the delay in the delivery of the Airbus A380, the Sanctioning Commission observed that this kind of information was based on the technical problems

[147] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390, 31.12.2004, pp. 38–57.

[148] DAIGRE, Jean-Jacques, *Note – Une information n'est privilégiée que si elle est précise et non publique, mais également sensible pour un investisseur raisonnable*, Bulletin Joly Bourse, 1 March 2010, No. 2, p. 107ff.

linked to delivery of different elements that should be used in production of the airplanes. It underlined that this kind of delay provoked by industrial inefficiencies occurs quite often and may be solved by improvement of the production procedure. Thus, such technical information does not concern the "set of circumstances"[149] that may be used by a reasonable investor in his decision-making process. In result, information that concerned the delay in delivery of the A380 was not inside information and its use or its non-publication could not be punished.

The alleged use of inside information concerning the increase of the cost of the development of the A350 programme forced the AMF's Sanctioning Commission to verify whether such an increase should be treated as inside information. Similarly as in the previous points, the result of this analysis was negative. The Commission simply observed that the probable change in the costs of the A350 programme had not be based on any official decision of any governing body of the company and had emerged from the declarations made by questioned employees of EADS. Meanwhile, the lack of the official decision concerning the change in the official planning of the A350 programme meant that the initial shape of the programme was binding. Thus, the information about the increase of the costs should be treated as non-existing and it was impossible to charge anybody for its use.

Finally, the Sanctioning Commission released EADS from the charges of false statements concerning the operating results and provisions of the results. It stated that although very optimistic, it could not be proved that such good results could not had been obtained. Moreover, it noticed that during the presentation of the estimated results it had not been precisely stated when such results should be achieved. For this reason it dropped the charge of making a false or misleading declaration.

In such a way the AMF's Sanctioning Commission found no reasons for punishment of any of the alleged insiders. It must be observed that in its examination of the gathered in the investigation data it took very lenient position. Regarding its evaluation of the operative planning the arguments that were used are quite surprising. Underlining the similarities between the planning and opinions of external analysts is not very convincing, although it is conform to the case-law of the French *Cour de cassation*.[150] Moreover, the fact that the planning had to be revised every year in order to update the provisions does not deprive it its potential value for the market participants. One does not have to be an expert to see the difference between the estimations made by an independent analyst and within the company. Even if the latter contains only general indications about the future provisions, it may disclose some data about company's plans and ambitions.

While analysing the delay in delivery of the A380 the Sanctioning Commission insisted on the fact that the delay was provoked by industrial problems and cannot be qualified as a set of circumstances that may influence an average market player.

[149] AMF's General Regulation, Article 621-1 II.

[150] MORTIER, Renaud, *Affaire EADS: mise hors de cause générale*, Droit des sociétés, No. 4, April 2010, comment 74.

Such an approach is not justified. It should be an investor that decides whether given information is precise enough to take a decision on its basis. Although the information about the delivery of A380 was based on industrial data and not on financial data, it could be interesting for the market participants.[151] In spite of the fact that the authority's analysis should be based on *ex ante* and not on *ex post* evaluations, it should be noticed that the disclosure of this information accompanied by the profit warning issued by EADS provoked an important decrease in the share's value. An opinion may be defended that similar tendency would be observed even if there was not any profit warning. Moreover, some contradictory statements may be found in the justification of the decision. On the one hand it underlines that the possible delay could be avoided through a better organisation of the production but, on the other hand, it declares that the delay was highly probable.[152] Finally, as it was rightfully observed by Jean-Jacques Daigre, the information concerning some industrial problems linked to production of the airplane may be seen as important by an average investor, who should be protected by the insider dealing prohibition, even if a specialist would not be alerted by such news.[153] Thus, the declarations made by the Sanctioning Commission that this kind of information should not influence the public seem to be unfounded.

The third alleged inside information concerned the increase in the costs of the development of the A350 programme. The AMF's Sanctioning Commission simply considered that as long as the increase of the expenses was not decided by the governing bodies of the company there was no inside information. Meanwhile, it should be noted that inside information does not have to be certain to be inside information. This is one of the difficulties of the examination of this notion. Inside information may exist without any official act of the company. If the position of the Sanctioning Commission was accepted it would make the analysis of the insider dealing cases much easier but it would also importantly limit the scope of the application of the prohibition.

In the end, the last part of the AMF's Sanctioning Commission did not concern insider dealing charges but allegation of the misleading or false statements concerning planned financial results issued by EADS. The Commission observed that such behaviour may be sanctioned only if the information presented to the public was based on false data that evidently could not be achieved. Such situation did not take no place in this case. Nevertheless, from the point of view of a non-professional market player, such declaration is not sufficiently protecting him. Even basing on true data the disclosed information may be evidently misleading. In case

[151] Similarly: MORTIER, Renaud, *Affaire EADS: mise hors de cause générale*, Droit des sociétés, No. 4, April 2010, comment 74.

[152] MORTIER, Renaud, *Affaire EADS: mise hors de cause générale*, Droit des sociétés, No. 4, April 2010, comment 74.

[153] DAIGRE, Jean-Jacques, *Note – Une information n'est privilégiée que si elle est précise et non publique, mais 'également sensible pour un investisseur raisonnable*, Bulletin Joly Bourse, 1 March 2010, No. 2, p. 107ff.

of EADS the statement presented in 2006 and concerning the very promising operational margin did not mentioned when it should be achieved. But it was presented directly after the declaration that referred to 2007. It could easily create an impression that all the presented information concerned that year. Meanwhile, the company had a larger perspective of 2010. The part of the truth may be wrongly understood. Therefore, the Sanctioning Commission should require that all data are presented to investors clearly and without omissions. Otherwise, the statements made to investors may require a high level of abilities in guessing what has not been told.

2 Luxembourg

a) Applicable Sanctions

Although quite new, the Luxembourg regulation of the sanctions applicable to insider dealing has already faced many important changes. The initial version of the Luxembourg project of an Act on Market Abuse provided application of the double, i.e. penal and administrative sanctions for violation of the insider dealing prohibition.[154] This approach was similar to the solutions existing in France. Particularly, it was based on the opinion expressed by the French Constitutional Council that had declared that double, i.e. criminal and administrative, prosecution, is not contradictory to the principle of fair proceeding and does not violate the *ne bis in idem* principle.[155] Therefore, the proposal concluded that the objective of the double prosecution would increase the number of the wrongdoers that disobeyed the prohibition. Simply, the administrative sanctions would let to punish those insiders that could not be punished in criminal proceeding because the presence of the malicious intent could not be proved.[156]

Eventually, such a solution was challenged by the *Conseil d'Etat* in its opinion of 15 November 2005.[157] In result, the Act on Market Abuse proposed a new, independent from the French experiences, system of punishment of insider dealing. The enacted wording of the Luxembourg insider dealing regulation provided application of criminal penalties and only limited use of administrative penalties that might be imposed directly by the CSSF. According to the general criminal

[154] Project of the law of the Luxembourg Parliament, Ordinary session 2005-2006, No. 5415, see also: POELMANS, Olivier, CONIN, Sandrine, *Le délit d'initié: première décision de jurisprudence et projet de réforme législative*, ALJB – Bulletin Droit et Banque No. 36, 2005, pp. 34–35.

[155] More details about this decision in the section "Coexistence of Criminal and Administrative Sanctions"of this chapter.

[156] POELMANS, Olivier, CONIN, Sandrine, *Le délit d'initié: première décision de jurisprudence et projet de réforme législative*, ALJB – Bulletin Droit et Banque No. 36, 2005, p. 34.

[157] Opinion of the Conseil d'Etat on the project of the law on market abuse of 15 November 2005, p. 8.

procedure rules, the competent court for the imposition of the criminal penalties is the *Tribunal d'Arrondissement*, acting as a criminal court.[158]

Such formulation was questioned by the European Commission that addressed to Luxembourg a reasoned opinion concerning, among others, the fact that the Luxembourg insider dealing regulation did not give the administrative authority the powers to impose sanctions.[159] In response to the reasoned opinion the Luxemburg parliament changed the Act on Market Abuse and extended the powers of the CSSF.[160]

The version of the Act on Market Abuse initially adopted provided some sanctions that were applicable only to the primary insiders, but in other cases both primary and secondary insiders were concerned. First of all, in case of a deliberate acquisition or disposition of financial instruments while in possession of inside information a primary insider should incur a penalty of imprisonment from 3 months to 2 years and a financial penalty of an amount ranging from EUR 125 to 1,500,000 or one of these penalties. The act specified that the value of the financial penalty may be up to ten times the profit realised without being less than this profit.[161] The same sanctions should be applied to an attempt.[162]

The penalty of imprisonment from 8 days up to 1 year and a financial penalty from EUR 125 up to 150,000, or one of them, might be imposed on an individual who had deliberately acquired or disposed of financial instruments while he had received inside information from a primary insider through disclosure of this information or through a recommendation made on a basis of inside information or while he was in possession of inside information (no matter what were the source) and he knew or should have known that the information he possesses is inside information.[163] Similarly as in the first case the act specified that the value of the financial penalty may be up to ten times the profit realised without being less than this profit and the same sanctions are applied to an attempt.[164]

Finally, a primary insider who deliberately disclosed inside information or made a recommendation on its basis may be subject to a financial penalty ranging from EUR 125 to EUR 25,000 and to imprisonment from 8 days up to 1 year, or to one of these penalties.[165] The act does not provide any penalties in case of an attempt.

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[158] Criminal Procedure Code, *(Code d'instruction criminelle),* Article 179(1).

[159] Information of 29 October 2009, IP/09/1633, concerning addressing to Luxembourg a reasoned opinion regarding incorrect transposition of Market Abuse Directive, available on: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1633&format=HTML&aged=0&language=EN&guiLanguage=en (last seen on 15 February 2011).

[160] For more details see: Project of the law of the Luxembourg Parliament, Ordinary session 2009-2010, No. 6081.

[161] Act on Market Abuse, initial version, Article 32.1.

[162] Act on Market Abuse, initial version, Article 32.5.

[163] Act on Market Abuse, initial version, Article 32.2.

[164] Act on Market Abuse, initial version, Article 32.2 and Article 32.5.

[165] Act on Market Abuse, initial version, Article 32.3.

During the works on the modification of the Act on Market Abuse, the *Conseil d'État* proposed that the introduction of the sanctioning powers of the administrative authority should be followed by the abolition of the criminal sanctions for the same behaviour.[166] Finally, the introduced amendments have not gone that far. Nonetheless, the modification was not a mere re-introduction of the initially proposed French system.

The current Luxembourg system of insider dealing prosecution provides that, for any violation of the insider dealing prohibition, the CSSF many inflict an administrative penalty whose amount may vary from EUR 125 to EUR 1,500,000. Additionally, if the act brought any profit, the penalty may be up to the ten times the profit realised without being less than this profit.[167] The CSSF informs the public prosecutor (*Procureur d'État*) about every administrative procedure that was launched. The latter has 3 days to decide whether he wants to launch a criminal proceeding. The CSSF may further proceed only if the public prosecution does not undertake any action. If, during its investigation, the administrative authority observes that an act of insider dealing was made by a primary insider who acted with the will to obtain, for himself or someone else, using any fraudulent mean, any unlawful profit, even indirectly, it discontinues its proceeding and transfer the case to the public prosecutor.[168]

The Act provides also the rules governing the case when the public prosecution is addressed directly with a claim that an act of insider dealing done by a primary insider took place. In such a situation the prosecutor should inform the CSSF. If the public prosecution opens an investigation the administrative authority should refrain from any action. However, if the prosecutor decides not to proceed, the CSSF should launch an investigation.[169]

In both cases presented above, if the public prosecution, during its investigation and before summoning to appear, considers that the conditions of the rules relating to criminal prosecution of insider dealing are not fulfilled but that the administrative penalty might probably be inflicted, it conveys the file to the CSSF and the administrative authority should continue the proceeding.[170]

As for to the criminal provisions of the Act, they were not modified as to the scope of the penalties applicable. However, it does not mean that they remained intact. They were changed so that the notion of "deliberate" character of the behaviour was replaced by a phrase "with the will to obtain, for himself or for someone else, using any fraudulent means, any unlawful profit, even indirectly".[171]

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[166] Opinion of the Conseil d'État on the project of the law No. 6081 of 4 May 2010, p. 3.

[167] Act on Market Abuse, as amended, Article 33.1 and 2.

[168] Act on Market Abuse, as amended, Article 33.4.

[169] Act on Market Abuse, as amended, Article 33.5.

[170] Act on Market Abuse, as amended, Article 33.4 and 5.

[171] Act of Parliament of 26 July 2010 amending the law of 9 May 2006 on market abuse and complementing the transposition of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), Article 4.

This modification is quite interesting. The requirement of "deliberateness" does not occur in the Market Abuse Directive. As it was explained in the Luxembourg doctrine after enactment of the initial version of the act, the notion of "deliberate" character of the behaviour in the legal description of the offence was added in order to underline the criminal character of the behaviour.[172] In fact, such a precision was not necessary. The Luxembourg criminal law applies one of the basic rules of criminal law. Simply, if a legal text does not introduce any modifications, a behaviour may be punished as an offence only if it was committed consciously and deliberately.[173] Thus, the abrogation of this notion did not change the interpretation of the rule. A question might be asked on the role of the newly added specification. In fact, it changes importantly the scope of the application of the rule. In order to punish an act of insider dealing with the criminal law penalty, the prosecution has to prove that action of the insider was oriented on profit. Such an objective is not required in order to inflict an administrative sanction. Moreover, this goal should be obtained through fraudulent means, which probably means that another criminal offence like theft of data should take place.

In consequence, the Luxembourg Act on Market Abuse provides a system of cooperation between the public prosecution and the administrative authority. Only one kind of procedure, administrative or criminal, may take place at a given moment. It means that one cannot be punished with both administrative and criminal sanctions. In such a way the legislature tried to assure the respect for the *ne bis in idem* rule.

It should be also noticed that the scope of the application of the criminal law is narrower than that of the administrative law. It is not only caused by the fact that criminal rules provide additional requirements that should be fulfilled in order to launch a criminal proceeding. The criminal law provisions distinguish, in general terms, conducting transactions by primary insiders in possession of inside information, conducting transactions by secondary insiders who obtained inside information from primary insiders or from whatever source if only they know that they possess inside information and, finally, disclosing inside information or making recommendation on its basis by a primary insider. That means that, although the Act on Market Abuse forbids it,[174] there is no criminal sanction for a secondary insider who discloses inside information or makes recommendation on its basis. Before the amendment, it seemed to be an omission of the Luxembourg legislature. The current shape of the prohibition applies to all possible violations of insider dealing prohibition administrative penalties. Thus, even if a criminal procedure cannot be launched, the CSSF may inflict administrative sanctions.

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[172] POELMANS, Olivier, CONIN, Sandrine, *Le délit d'initié: première décision de jurisprudence et projet de réforme législative*, ALJB – Bulletin Droit et Banque No. 36, 2005, p. 34.

[173] SPIELMANN, Dean, SPIELMANN Alphonse, *Droit pénal général luxembourgeois*, Bruylant Bruxelles, 2004, p. 327.

[174] Act on Market Abuse, as amended, Article 10.

The introduction of the new sanctioning powers of the administrative authority has not limited the ones it had before the amendment of the Act on market abuse. In consequence, the CSSF may make public information about the penalties applied in relation with the violation of the insider dealing provisions. This is made on the expenses of the sanctioned party and the only limitation of this CSSF's power is that such publication cannot seriously disturb the financial markets or provoke the disproportionate harm to the sanctioned party.[175] Finally, the CSSF has a very important power over finance companies as well as financial market professionals that were found guilty and the individuals acting under the authority or on behalf of mentioned entities. It may forbid them to exercise for a period not longer than 5 years all or part of its/his activities. Such penalty, even if administrative in nature, may provoke the same professional consequences as a death penalty for an individual.

b) Judicial Decision

The first judgment of the Luxembourg court (*Tribunal d'arrondissement*) in the domain of insider dealing was rendered on 13 July 2004. The judgment was based on the old Luxembourg insider dealing regulation of 1991. However, because of the relatively small differences between the previous and current insider dealing regulation, it may be assumed that a similar decision would be issued under the new law. However, it should be remembered that this judgment was rendered in criminal procedure and maybe, currently it would result "only" in an administrative decision.

The circumstances of the case were as follows[176]: G. was working for the company Arbed as a head of the investor relations department. In the beginning of 2000, Arbed entered into some preliminary negotiations with the company Usinor. The negotiations in July 2000 were extended also on the company Aceralia. Because of their importance, they were all conducted on a high level within each of the participating companies. Three potential partners signed the first agreement on a possible merger on 15 December 2000. At the end of January 2001, they agreed on general conditions of the exchange of the shares of each company. Finally, the memorandum of understanding was signed on 16 February 2001 and the information about the merger was made public 3 days later.

Because of the confidential character of the negotiations, G. has not learnt about them before the end of November or the beginning of December 2000. He was asked by his supervisor to prepare an analysis of the influence of the potential merger on the investors of Arbed. He also participated in two meetings with the employees of the Arbed's bank in January 2001. During these meetings the issue of

[175] Act on Market Abuse, as amended, Article 33.6.

[176] Judgment of the *Tribunal d'arrondissement* in Luxembourg, of 13 July 2004, ALJB, Bulletin Droit et Banque, No. 36, 2005, pp. 57–62.

a potential merger was discussed. G. took also part in an internal meeting at the beginning of February 2001, dedicated to the upcoming changes. In the meantime, at the end of January 2001 he bought 143 shares in Arbed for a price of about EUR 86.45 each (he was already in possession of 30 shares acquired in 1997 and 1998). Finally, in February 2001, after public disclosure of information about the merger, he sold 100 shares for EUR 121.63 each.

The prosecution (*Ministère Public*) charged him for a violation of Article 2 of the Act of Parliament of 3 May 1991 on the insider dealing. The court agreed with the prosecution and sentenced G. for a financial penalty of EUR 4,500. Its amount was calculated on the basis that the profit G. allegedly made through his inside transactions was EUR 3,522.50 (before imposition). The profit was simply calculated as a difference between the price of acquisition and disposal of the shares.

The analysis of the court's reasoning in this precedential case requires attention. G. was accused of insider dealing: making transaction on a basis of unknown to the public information about planned merger of three companies. Therefore, the court was obliged to verify whether the defendant fulfilled all the elements of the insider dealing offence. It should have started by verifying whether G. was in fact in possession of inside information. The constitutive elements of inside information are: not being into public domain, being precise, relating to one or more issuers or one or more financial instruments, and being likely to have a significant effect on the price of this financial instrument. G. raised an objection that he was not participating in the negotiations between the companies and he had only general knowledge that some negotiations were taking place. Besides, he claimed that before these specific negotiations, the others had already taken place and they have not had any important influence on the price of the shares of Arbed. Finally, he claimed that in the official brochure addressed to the investors in the section "External growth", information about "opportunities under review or in negotiations" showed the possible intentions of the company.

The court concentrated on a precise character of the information possessed by G. It underlined, relying on the French case-law, that the notion of precision is not equivalent to the notion of certainty. G. obtained the information about negotiations from his supervisor. He made an analysis of the potential impact of the merger on his department. Therefore, the scope of the data he possessed exceeded a simply gossip and had a specific content. It was precise enough, even if it concerned only a possibility of a merger. As for the other elements of inside information, the court treated them very briefly and, in some way, assumed their existence. In the statement that information had not been made public, it did not analyse the existence of the mentioned note that could be found in the brochure addressed to investors. It just stated that negotiations between three companies were conducted on a high level and that information was available only to few persons. It did not even try to examine (and neither did the prosecution) what in fact the investors and market analysts knew at that moment about the negotiations, whether there were any gossips on the market about possible changes in the ownership structure. Moreover, it did not analyse the possible influence of the disclosure of the information on the price of the shares. The court did not try to make any estimation of what

would be the price of the shares on the day of their disposal of in case if no negotiations were conducted or if the planned changes smaller scope. The fact that previous negotiations conducted by Arbed did not influence significantly the price of its shares is simply commented as not being useful for evaluation of possible influence of information on merger of three big companies. But this statement is not supported by any analysis that would compare the two negotiations. Moreover, this court's opinion is contradictory to the guidance given by the CESR which underlined that, in order to evaluate possible price effect, information should be compared to the other similar information that had (or not) in the past significant effect on prices.[177] But the court did not propose its own model of evaluation that would be based on different factors and not on the previous market behaviour.

After having stated about the inside character of the information concerning the merger, the court also declared that G. was an insider. Although he was not participating in the negotiations, he learned about them from his supervisor. Therefore, he obtained the information by virtue of the exercise of his employment and the notion of insider could be applied towards him.

G. was charged of acquisition and disposition of the shares in Arbed, while being in possession of inside information. Moreover, as the Luxembourg regulation at the time of the alleged breach was based on the wording of the Insider Dealing Directive, the breach should have been done by taking advantage of that information with full knowledge of facts.[178] This requirement, as it was mentioned above, is not binding any more.[179] The court declared that the transactions led by G., i.e. the acquisition of 143 shares at the end of January 2001 and the disposition of 100 shares in February 2001 entered into the scope of application and violated the insider dealing prohibition. Relying on the established facts, it stated that G. was in possession of inside information while he made transactions in the shares and he took advantage in the amount of EUR 3,522.50 (before taxes). The court did not accept the explanation given by G. based on the fact that he was in possession of 30 shares that he had acquired a few years before and that the transaction in February 2001 comprised also these shares. That would mean that their acquisition should not be considered to be made on a basis of inside information (at least the one examined in this case). In fact, the immaterial character of shares in any company does not allow determining which shares, bought on which day, were disposed of. Therefore, the principle of *in dubio pro reo* should be applied. In the lack of other evidence, the court should have applied the version that would be the most favourable for the accused. At least, the court did not apply the most severe version based on the fact that some shares still remained in the possession of G. and probably their value at the day of rendering the verdict was bigger than on the day they had been bought. Thus, if the court started to examine all of G.'s alleged

[177] CESR, Level 3 – second set of CESR guidance and information on the common operation of the directive to the market, p. 4.

[178] Act of Parliament of 3 May 1991 on insider dealing, Article 2.1.

[179] See section "Forbidden Practices", Chap. 1.

profits, he would risk being charged with a penalty taking into account this not realised increase in value of his possession.

Besides, it should be noticed that the notion of full knowledge of facts was not mentioned in the court's decision. At the day of the alleged breach it was a constitutive element of the offence and consequently it should have been demonstrated by the court in the judgment. The notion of the full knowledge of facts is as difficult to prove as the potential influence of information on price of financial instruments. The court did not even try to prove its existence in the case of G. It was probably partly caused by the fact that in the judgment it was few times stated that G. did not have full knowledge about the facts concerning the merger and his access to the data was only partial. Thus, it would be difficult for the court demonstrate on this basis that this legal condition was fulfilled. But the appropriateness of the court's verdict is undermined by such an omission.

Finally, the judgment speaks very briefly about the core of the criminal responsibility, i.e. the guilt of the accused person. The court stated only that the fact that the transactions conducted by G. had a relatively small scope and were declared to the tax office did not mean that he did not intent to commit a wrongful act. But neither the guilt nor the intent were not analysed furthermore.

In consequence, as it was demonstrated above, the intent of the court to punish the first accused Luxembourg insider was so strong that important elements of criminal responsibility were not established. The current wording of the insider dealing regulation, as the notion of the full knowledge of facts and taking advantage were repealed, would probably be warmly welcomed by the court that, nevertheless, did not tried to examine these notions in the analysed case. However, the foundation of criminal responsibility did not change. Guilt as well as intent and all elements of infraction mentioned in the criminal law have to be proved. Otherwise, one can speak about the violation of the principles of the fair proceeding and other well established principles of criminal law (e.g. principle of legality, *in dubio pro reo,* etc.). Moreover, the court, while analysing some charges against G. used the way of reasoning characteristic for civil law and stated, e.g. that the charges that were not contested by the accused should be considered proved.[180] Such an approach should not have taken place in any criminal proceeding. Each accused has a right to remain silent and it does not mean that he pleads guilty and it should not be evaluated by a court against him. Thus, such a statement is surprising and additionally challenges the correctness of the rendered verdict.

[180] Judgment of the *Tribunal d'arrondissement* in Luxembourg, of 13 July 2004, ALJB, Bulletin Droit et Banque, No. 36, 2005, p. 61.

3 England and Wales

a) Administrative Sanctions

The FSMA 2000 grants the FSA very wide competences to sanction those who violate the insider dealing prohibition. The regulation does not provide any limits for the sanctioning powers of the FSA. It may impose on a person engaged in market abuse a penalty of such amount as it considers appropriate.[181] The act creates, however, a special procedure that must be respected by the authority. The imposition of a penalty should be preceded by the issuance of a warning notice addressed to the suspected person.[182] In response to it, said person may present sensible arguments in order to justify that he or she believed, on a reasonable ground, that his behaviour did not fall within the scope of the market abuse prohibition or he took all reasonable precautions and exercised all due diligence in order not to fall within the scope of the prohibition. If these arguments are well-founded, the FSA may refrain from imposing the penalty.[183] The final decision is taken by the administrative authority.

Moreover, if the imposition of a financial penalty was justified, the FSA may decide not to inflict it and publish only a statement declaring that a given person has engaged in a market abusing behaviour.[184]

In order to limit the "unlimited" powers of the FSA to impose the financial penalties and to make its decision more foreseeable, the FSMA 2000 provides two important legal restraints.

First of all, the FSA has to elaborate a statement of its policy concerning the imposition of the penalties and the factors taken into account in order to determine the amount of the imposed penalty.[185] These rules can be found in the FSA Handbook, especially in its Decision Procedure and Penalties Manual.[186] It means that the FSA should act in accordance with its own rules. However, it should be noted that these rules do not have the stability of the acts of parliament and may be easily changed.

The second limitation to the FSA's powers is the right of a person on whom a penalty was imposed or a public statement was made to refer to the Financial Services and Markets Tribunal (hereinafter referred to as "FSMT").[187] The FSMT is an independent judicial body established under the FSMA 2000.[188] Its powers are

[181] FSMA 2000, Section 123(1).
[182] FSMA 2000, Section 127.
[183] FSMA 2000, Section 123(2).
[184] FSMA 2000, Section 123(3).
[185] FSMA 2000, Section 124(1).
[186] Available at www.fsa.gov.uk
[187] FSMA 2000, Section 127.
[188] FSMA 2000, Section 132.

not limited to the analysis of the conformity of the FSA's decision with the existing regulations but it is entitled to review the whole case and to change the FSA's decision according to the findings made before the FSMT.[189] Finally, there is a possibility to appeal the decisions of the FSMT before the Court of Appeal, but such appeal requires prior FSMT's permission.[190]

Although the financial penalty and issue of a public statement are the main penalties that may be applied by the FSA in order to prosecute insider dealing, the FSMA 2000 provides a much wider scope of other administrative sanctions that may be inflicted. After detection of a market abusing behaviour, the FSA may apply to the courts for orders of injunction to restrain probable violation of the insider dealing prohibition, to prevent the further acts of insider dealing or to restrain the concerned person from disposing of his assets.[191] Moreover, if there are any established victims of insider dealing, the FSA is entitled to apply to the courts for an order that requires the alleged insider to pay a sum that is distributed by the FSA to the victims.[192] Alternatively, the FSA may choose to ask the insider to make the restitution directly to the individuals who suffered losses because of his or her behaviour.[193] Besides, when a person engaged in insider dealing performs specific regulated activity, the FSA may (depending on the case) prohibit further activity,[194] change the scope of the granted permission,[195] or withdraw its approval for this activity.[196]

Fulfilling the obligation imposed by the FSMA 2000, the FSA has issued its Handbook of Rules and Guidance, composed of numerous parts, in which it explains the notions used in the FSMA and presents its policy regarding the FSA's powers.[197] The FSA Handbook is composed of numerous sourcebooks or manuals that tackle different aspects of the FSA's activity. What should be noted is that, since 2002, the FSA has already released 110 versions of its Handbook.[198] Although of course the FSA Handbook tackles many subjects and only part of the changes concerned the market abuse rules, it is evident that it is modified very

[189] *James Parker v. the FSA*, 11 may 2006, paragraph 24: "We have an entirely original jurisdiction, to be exercised on the evidence available to us (whether or not it was available to the Authority [i.e. The FSA]".

[190] Financial Services and Market Tribunal Rules 2001, Section 23.

[191] FSMA 2000, Section 381.

[192] FSMA 2000, Section 383.

[193] FSMA 2000, Section 384.

[194] FSMA 2000, Section 56.

[195] FSMA 2000, Section 45.

[196] FSMA 2000, Section 63.

[197] Whole text of the FSA's Handbook is available at www.fsa.gov.uk

[198] As for the 19 February 2011 – the last version was released on 15 February 2011 (available at http://www.fsa.gov.uk/pages/Library/Policy/Handbook/Releases/2011/110.shtml, last seen on 19 February 2011), the full list of modification may be found on http://fsahandbook.info/FSA/whatsNew.jsp#DES3 (last seen on 19 February 2011).

often. One may doubt whether such frequent modifications are really needed. It may be admitted that the frequent revision gives an opportunity to react quickly to the changes that take place on financial markets and answer the needs of the protected investors. But it creates an obligation for all market participants to observe the FSA's activity very attentively. Otherwise, they risk serious consequences of non-compliance with the provisions of the Handbook.

As it was mentioned above, in relation to insider dealing, the legal powers of the FSA are very wide, including the right to impose an unlimited financial penalty. Thus, in order to limit the legal uncertainty the relevant section of the FSA Handbook[199] deals with the rules and factors taken into account in order to determine the appropriate penalty for this behaviour.[200]

According to the FSA Handbook, the FSA first decides whether or not it should take action for a financial penalty or public censure.[201] Then, it decides what kind of action is more appropriate.[202] The penalty-setting regime is based on three criteria:

- disgorgement (no one should benefit from any breach),
- discipline (wrongdoing should be punished),
- deterrence (individual, i.e. concerning the one who committed the breach, and general, i.e. concerning all other market participants).[203]

In consequence, the FSA takes action after analysis of the following factors: the nature, seriousness and impact of the suspected breach, the conduct of the person after the breach, the previous disciplinary record of the person, its own guidance, action taken in previous similar cases, and action taken by other domestic or international regulatory authorities.[204] Moreover it may consider the degree of sophistication of the users of market and the impact that the penalty or public censure may have on the financial markets.[205] When deciding on the kind of action, the issue of public censure is more probable when the breach was not serious in nature or degree, no profit was made or no losses were avoided, the full and immediate co-operation with the FSA was provided, and no disciplinary records relating to the same person or entity existed as well as deterrence might be effectively achieved without imposing financial penalties.[206]

Nevertheless, if a decision in favour of a financial penalty is taken, the FSA uses the similar criteria as in the first step in order to set the appropriate level of a penalty. The determination of the total amount of the penalty should respect two

[199] Released in May 2010.

[200] Decision Procedure and Penalties Manual, Chapter 6 Penalties.

[201] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.2.1.

[202] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.4.1.

[203] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.5.2.

[204] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.2.1.

[205] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.2.2.

[206] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.4.2.

elements: disgorgement of the profits resulting from the breach and an additional "penalty" *sensu stricto* that reflects the seriousness of the breach and has punitive character. While establishing these elements, the FSA is obliged to respect its five-step framework. First, all the financial benefits derived directly from the breach should be removed. This includes also interest on the benefit.[207] Then, the seriousness of the breach is examined. This is the most important part of the analysis made by the FSA. It takes into account all the factors relating to the impact of the breach, its nature (i.e. the character of the rules that were breached, its frequency, whether the position of trust was abused, etc.), whether it was deliberate or reckless. On this basis the FSA establishes the amount of the penalty. In the case of companies and other entities that are not natural persons it may be up to 20% of their 12 months' revenue.[208] For individuals, the rules are more complicated. The value of the penalty, depending on the seriousness of the breach, may be based on a percentage of the individual's relevant income, a multiple of the profit made or loss avoided or, in cases of the breaches assessed to seriousness 4 or 5 (on a five levels' scale) the penalty is at least GBP 100,000.[209] After assessment of the amount of the penalty the next three steps aim at adjusting it to the proper level. At the beginning, the mitigating or aggravating factors (such as the degree of cooperation demonstrated by the investigated entity or individual) are taken into account. Then, if the FSA considers that the established figure is insufficient to deter the wrongdoer or others, it may increase the penalty.[210] The FSA Handbook does not provide any further explanations to what extent this adjustment can be made. Finally, a possibility of a settlement discount with an insider exists but it never applies to the part of the penalty that aims at the disgorgement of the benefits.[211]

While analysing the FSA Handbook, it should be remembered that the lists of the criteria used by the authority in order to decide whether and how it should take action are non-exhaustive.[212] The FSA may apply also other criteria, if it finds it justified.

It should be also noted that according to the FSA Handbook, the principal purpose of imposing financial penalty or issuing a public censure is "*to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour*."[213] Therefore, it is clearly visible how important the role of deterrence for the FSA is. The list of the factors that are important for the

[207] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Sections 6.5A.1 and 6.5C.1.

[208] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.5A.2.

[209] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.5C.2.

[210] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Sections 6.5A.4 and 6.5C.4.

[211] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Sections 6.5A.5 and 6.5C.5.

[212] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Sections 6.2.1 and 6.4.1.

[213] Decision Procedure and Penalties Manual, Chapter 6 Penalties, Section 6.1.2, italics omitted.

authority while investigating the suspected behaviour also shows that, although the value of the gain or loss avoided is taken into account, the objective of the financial penalty is not the compensation of a victim (which may be explained by the fact that, in most of the insider dealing cases, he or she cannot be defined) but the punishment of the person who engaged in insider dealing and individual and general deterrence. For many authors, deterrence is a main objective of criminal law.[214] Thus, it may be observed that this insider dealing regulation is playing a similar role to the one that criminal law could have. Because of this resemblance to criminal proceedings, in order to protect the rights of the persons investigated for violation of the insider dealing prohibition, the FSMA 2000 contains the provisions that allow the person appealing to the FSMT to ask for legal assistance.[215] As the character of the financial penalty imposed by the FSA is similar to the one in the criminal proceeding, a question may be asked on whether the FSA is obliged, during its investigation, to the same standards of proof as it is required in the criminal prosecution. The answer to this question was given by the FSMT that stated that the standard of proof must be proportionate to the gravity of the investigated act. In such a way, the bigger the amount of the imposed penalty is, the stronger the evidence collected by the FSA must be.[216]

It should be underlined that the market abuse regime that can be found in the FSMA 2000 was not intended to replace the already existing criminal law. It was rather constructed in order to supplement it and it made it possible to cover a wider scope of behaviours.[217] That is why, besides the administrative powers given to the FSA, it may consider pursuing prosecution of the criminal offence of insider dealing under the CJA 1993.[218] Thus, the FSA decides alone whether to launch the criminal prosecution or the administrative proceeding. Launching criminal proceedings imposes on the FSA the obligation to respect the Code for Crown Prosecutors.[219] The main obligation imposed by this Code is the Full Code Test.[220] The Test is composed of two stages, namely "the Evidential Stage" and "the Public Interest Stage". The objective of the Evidential Stage Test is to verify whether the gathered evidence is sufficient to provide a realistic prospect of conviction against each defendant on each stage. Thus, it is not only important to check if there is enough evidence to launch the whole procedure, but also whether it is reliable and can be used. The second stage of the Test, which can be made only after the first

[214] See: Sect. B.I, Chap. 3.

[215] FSMA, Sections 134–136.

[216] *Arif Mohammed v. FSA*, of 9 March 2005, for more details see section "Arif Mohammed"below.

[217] SWAN, Edward, *Market Abuse Regulation*, Oxford University Press, 2006, p. 159.

[218] FSMA 2000, Section 402.

[219] Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD), CESR/ 07-693, 17 October 2007, p. 478.

[220] Code for Crown Prosecutors, Section 5.

stage of the Test had been successfully passed, analyses the public interest factors that are both for and against prosecution, and, having regard to the seriousness of the offence and all the circumstances, decides whether criminal prosecution is in public interest.

Comparing the scope of the proof that must be collected by the FSA, respectively in administrative and criminal proceeding, and taking into account the fact that it may launch both kinds of proceeding, one may draw the conclusion that it can easily switch from one type to another, basing on the chances of successful conviction before the criminal court. If collected evidence about the facts but also about the guilt of the examined person are strong, the criminal prosecution may be launched. If the gathered proofs are not so convincing, the FSA may decide to impose an administrative penalty, based on the rule accepted by the FSMT that the evidence should be proportionate to the scale of the breach of the FSMA 2000.

b) Criminal Sanctions

The CJA 1993 provides two kinds of penalties that may be applied in order to punish a person who breaches the prohibition of insider dealing. The maximal penalties that may be imposed on an individual that was found guilty are, as in the case of the FSA's powers, unlimited fine or a sentence of imprisonment of up to 7 years, or both.[221]

c) Case-Law

i. Criminal Case

The first criminal insider dealing case brought by the FSA before a criminal court was judged in March 2009.[222] It concerned a simple, classical case of insider dealing. Christopher McQuoid was an insider, a solicitor working with the TTP Communications' legal counsel. When he learned about the takeover negotiations with Motorola Inc., he passed information to his father-in-law, James Melbourne. Two days before the takeover offer was announced, James Melbourne bought shares in TPP Communications. After the announcement, the shares were sold with a total profit of GBP 48,919.20. At that time, James Melbourne did not make any other deals in the share market. Three months after the transaction Christopher McQuoid received from his father-in-law a cheque for GBP

[221] CJA 1993, Section 61(1), Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD), CESR/07-693, 17 October 2007, pp. 455–478.

[222] The FSA's markets regulatory agenda, May 2010, p. 43.

24,459.60. It was exactly the half of the profit made while disposing of the TTP Communications shares.

The circumstances were quite simple – there was an insider who knew about the promising deal proposition and tipped off his relative to profit from it. They hoped the transaction made by James Melbourne would be unnoticed by the FSA. Moreover, they waited 3 months to split the profit they made. After that time they must have been feeling quite safe; they transferred the money in one cheque of the precise value.

Unfortunately for them, the FSA learned about the transaction and found the evidence of insider dealing so strong that it decided to bring the matter to the criminal court. The court agreed with the competent authority. It found both men guilty and sentenced them to 8 months of prison. Christopher McQuoid was given an immediate sentence. And his father-in-law, due to his age, had his sentence suspended for 12 months.[223]

It is interesting to read the justification of the verdict given by Judge Testar: "*The evidence revealed deliberate and calculating behaviour on the part of both of you. This is not the victimless crime – this is a crime which does undermine confidence in the integrity of the market, and this is a confidence which is of great importance to the economic welfare of the community as a whole. In addition, it does seem to me that the public are entitled to be angry if people who are in possession of inside information treat that possession as a licence to print a substantial amount of money*."[224]

This justification shows the most characteristic elements of the position of the advocates of the prohibition of insider dealing. First of all it justifies the prosecution of insider dealing as a crime on the basis of a supposition that this behaviour victimises the whole market and confidence towards it. It should be noted that Judge Testar does not refer to any specific victims of the transaction concluded on the stock exchange but considers as a victim the market in general. The second argument is based on an assumption that a profit made on the basis of inside information is unfair towards the others, who do not have the privilege of the access to it. Both of these arguments were analysed in Chapter 1.

ii. Administrative Cases

1. Arif Mohammed. The case of the Arif Mohammed is relatively old – the FSMT rendered its judgment in 2005.[225] However, there are still some interesting issues because it was the first insider dealing case in which the addressee of the FSA's decision decided to appeal to the FSMT.[226]

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[223] The FSA's markets regulatory agenda, May 2010, p. 43.

[224] The Herald, internet edition, published on 31 March 2009, available at: http://www.heraldscotland.com/solicitor-jailed-after-insider-trade-with-his-father-in-law-1.906356 (last seen on 15 February 2011).

[225] *Arif Mohammed v. FSA*, of 9 March 2005.

[226] *Arif Mohammed v. FSA*, of 9 March 2005, paragraph 4.

The FSA punished Arif Mohammed for using confidential, non-public information about the sale of the division of a listed company that he had learned in the course of his employment with PriceWaterhouseCoopers (hereinafter referred to as "PWC") with a financial penalty of GBP 10,000.[227] Arif Mohammed made his inside deals on the basis of information about the future client's transactions obtained from other co-workers. Arif Mohammed had not personally engaged in consultations for this client. Besides the provisions of the FSMA 2000, his deals violated PWC's internal regulations concerning the ban of entering into transactions concerning the shares of the company's clients. Arif Mohammed's transactions resulted in a financial gain of GBP 3,750. When the FSA imposed a financial penalty for his inside deals, he decided to appeal to the FSMT.

The FSMT, which has been sentencing in an insider dealing case for the first time, had an opportunity to make a statement about its own powers regarding the possibility of full review of all matters addressed to it in the appeal. Moreover, it accepted the possibility to take into account, during the appeal, the proofs that were unavailable in the phase of the investigation before the FSA.[228]

Another important issue that was analysed in this case is that the FSMT accepted the FSA's position concerning the "sliding scale" of the proof required in order to justify the penalty. That meant that, although the FSA was obliged to prove its cases beyond a reasonable doubt, the evidence to prove the allegation had to be more cogent in more serious allegation than in the smaller ones.[229] In the case of Arif Mohammed, the FSMT concluded that the proofs presented to it were sufficient to impose a penalty.

2. James Parker. The theory of "sliding scale" was further reaffirmed by the FSMT in the case of James Parker (still on the basis of the pre-Market Abuse Directive version of the FSMA 2000).[230]

The FSA stated that James Parker had engaged in insider dealing when he dealt in and spread bet on shares of the company he was working for (Pace Micro Technology plc, hereinafter referred to as "Pace"). To sanction this behaviour, it ordered James Parker to pay GBP 300,000, which amount was composed of one part that covered the benefits he allegedly made (GBP 150,000), and the remainder of the penalty was presumed to constitute the "punishing" part of the penalty. James Parker appealed to the FSMT on two bases. He claimed that the transactions he had entered into were part of his investment strategy and, in case he was found liable to penalty, he considered that the amount of the penalty was excessive.

James Parker worked in Pace as its credit risk and treasury manager. He was dealing in the Pace shares for some time as well as he hedged his transactions through spread betting. Most of the time, his transactions were balanced and

[227] *Arif Mohammed v. FSA*, of 9 March 2005, paragraph 1.

[228] *Arif Mohammed v. FSA*, of 9 March 2005, paragraph 4.

[229] *Arif Mohammed v. FSA*, of 9 March 2005 paragraph 5.

[230] *James Parker v. FSA*, of 11 May 2006.

protected him against big variations in the value of the shares. However, few days before the publication of profit warning by Pace, he sold all his shares and engaged in spread bets that would expose him to the large losses in case of the increase in the value of the shares. Meantime, after the profit warning, the value of the shares dropped, so not only did James Parker eliminate losses that would have appeared because of the decrease in the value of the shares but he also profited from the spread betting. The amount of the profit he made was evaluated by the FSMT at about GBP 135,000. During the FSMT's investigation of the case it was noted that the Pace profit warning was presented to the market after the issue of a misleading announcement for investors few months before. The content of the announcement was so deceptive, that the FSA imposed on Pace a penalty.[231]

Besides, as in the case of Arif Mohammed, James Parker violated Pace's internal rules concerning the dealings; in this case, the rules relating to the company's own shares.

On the basis of the gathered evidence, the FSMT stated that James Parker acted while in possession of inside information and that his behaviour just a few days before the announcement of a profit warning could not be considered as a part of any strategy. Therefore, it found the imposition of a financial penalty justified. Nevertheless, it reduced the final amount of the penalty in light of the *in dubio pro reo* principle.[232] The FSMT calculated the profits made by the appealing applicant as about GBP 15,000 – GBP 20,000 smaller than stated by the FSA. Having into regard the nature of the penalty, which must be punitive and deterrent, the FSMT reduced its amount to GBP 250,000 and stated that any smaller value would not reflect the importance of the wrongdoing.[233]

The FSMT analysed in this case the criminal or "civil" (which should be understood as "administrative") character of charges in market abuse cases. The distinction is important because Article 6 of the European Convention on Human Rights (hereinafter referred to as "ECoHR") imposes certain obligations, or minimal rights of the accused person, on the state authorities in case of a criminal proceeding. In spite of the fact that FSA may choose between criminal prosecution and administrative sanction, the latter investigation was called by the FSMT as "punitive and deterrent in character". Thus, it should be treated for the purposes of the ECoHR as a criminal charge.[234] However, the FSMT stated that even if a charge is considered to be criminal, the ECHR does not contain a requirement to establish the charge beyond a reasonable doubt, and therefore, the standard of proof should be established within the law of procedure.[235] In this respect, the FSMT agreed with

[231] *James Parker v. FSA*, of 11 May 2006, paragraph 72.
[232] *James Parker v. FSA*, of 11 May 2006, paragraph 161.
[233] *James Parker v. FSA*, of 11 May 2006, paragraph 178.
[234] *James Parker v. FSA*, of 11 May 2006, paragraph 20.
[235] *James Parker v. FSA*, of 11 May 2006, paragraph 22.

the previous cases[236] and concluded that the standard of proof should be increasing in line with the increasing value of the penalty imposed (the rule of the "sliding scale"). Because in James Parker's case, the value of the penalty imposed by the FSA was GBP 300,000, the FSMT's opinion was that the standard of proof required had to be very high and in practice it would be difficult to distinguish it from the requirements applied in the criminal procedure.[237]

The opinion of the FSMT is surprising. In spite of admitting that the charges imposed by the FSA should be considered as criminal, it stated that the standard of proof may vary depending on the value of the possible penalty imposed by the FSA. That means there is not one clear standard of proof imposed on the FSA. Thus, in the case of the persons presumably engaged in the market abusing behaviour of a smaller scope, the requirements imposed on the FSA in order to justify an imposed penalty would be limited. That would be, despite the fact that in smaller cases the character of the financial penalty is the same as in the bigger ones – to punish the one found guilty and to discourage the others.

Moreover, the FSMT considers that the importance of the imposed financial penalty should be evaluated in relation to the revenues and savings of the punished individual (in the *Parker* case the FSMT analysed the incomes of James Parker,[238] in the case of Arif Mohammed, the value of his house and his wife's savings were taken into account). It may seem to be rational in order to achieve the objectives of the regulation. But on the other hand, it may lead to substantial differences in the penalties imposed in different cases characterised by similar circumstances. And if the FSMT's opinion about "criminal-like" character of the proceeding before the FSA is accepted, such disparities should not take place.

This insider dealing case reveals also an interesting aspect of victims. Insider dealing is usually presented as a victimless crime. And, usually, it is impossible to indicate whose rights were violated by the insider misbehaviour. That is the reason why very often the market as a whole, trust of the other market players, etc are mentioned as the victims of insider dealing. Meanwhile, it this case, the strategy of James Parker was based on the spread betting with a private company. These bets, that he made on the value of the shares, originate in fact from sport bets. And, as in the case of every bet, they are based on an assumption that the final result of the bet is unknown for both of its participants. Therefore, in the case of James Parker's better knowledge about certain facts, his counterparty had no chance to win the bet.[239] That explains why the betting company decided to inform the FSA about the suspicious transactions. One may ask, however, whether an intervention of an administrative body is the best solution to resolve a dispute between the market

[236] Especially: *Arif Mohammed v. FSA*, of 9 March 2005, see above.

[237] *James Parker v. FSA*, of 11 May 2006, paragraph 23.

[238] *James Parker v. FSA*, of 11 May 2006, paragraph 33.

[239] *James Parker v. FSA*, of 11 May 2006, paragraphs 106–110, 157.

participants, especially given that finally the penalty was paid to the state and not to the party to the contract that had suffered losses.

4 Poland

The Polish regulation is based on criminal liability for the breach of the insider dealing prohibition. In practice, however, the public prosecutors are informed about a suspected breach by the KNF, i.e. the administrative authority. Thus, two phases of the proceeding can be distinguished. First, in order to determine whether the insider dealing regulation was violated, the KNF may launch a special explanatory proceeding.[240] This kind of proceeding is of a special character because the provisions of the Polish Code of Administrative Procedure are applied to it only in a very limited scope.[241] During this proceeding everyone who has a specific knowledge or a specific document or information carrier may be requested to give written or oral explanations or to release such document or another information carrier. The KNF has also been vested with the other powers that are provided by the Market Abuse Directive, such as the possibility to require existing telephone records, or to freeze the accounts of financial instruments. However, it cannot collect evidence based on opinions of court experts, interrogation of persons or other actions that require preparation of a report according to the Polish Code of Administrative Procedure. The justification for this regulation is that under Polish law the responsibility for insider dealing is criminal responsibility. After detection of a suspected behaviour the KNF starts an explanatory proceeding and then, its Chairman decides to close the explanatory proceeding or to file a notification of a suspected offence to the public prosecution. The rest of the procedure is conducted under the rules governing the criminal proceedings. The law provides only the possibility for the KNF to participate in the procedure as an injured party, which in practice gives no real possibility to influence the proceeding.

The complete criminalisation provided by the existing regulation differs from the one repealed in 2005 that distinguished two kinds of proceeding basing on the value of the benefit made by a person who breached the regulation.[242] If its value was smaller than the value of the minimal monthly income multiplied by 200,[243] the financial penalty was imposed in an administrative proceeding. If a bigger profit had been made, the case was transmitted to the Public Prosecution and then prosecuted under a criminal proceeding. That meant that depending on the value

[240] Act of Parliament of 29 July 2005 on Capital Market Supervision, Article 38.

[241] Act of Parliament of 29 July 2005 on Capital Market Supervision, Article 38.1.

[242] Act of Parliament of 27 August 1997 on Public Trading in Securities *(Ustawa z dnia 21 sierpnia 1997 r. - Prawo o publicznym obrocie papierami wartościowymi)* published in Dz. U. 1997, No. 118, item 754, as amended, repealed on 24 October 2005.

[243] It is a threshold established by the Polish Criminal Code for the notion of a property of a significant value (Article 115 §5).

of the financial gain, the scope of the investigation as well as the elements of a breach that must have been proved by an investigating body would be different. The different value of the benefit made influenced (among others) the extent of the proof needed in order to impose penalty: in an administrative proceeding the issue of the personal guilt is not relevant. Meanwhile, it is one of the pillars of criminal prosecution.

The current regulation repealed this distinction and applies criminal law to all persons allegedly breaching the insider dealing regulation. The penalties that may be applied differ on the basis of the character of the breach and the quality of the breaching person. The use of inside information is punished by a financial penalty of up to PLN 5,000,000 (about EUR 1,250,000) and/or imprisonment for a period from 3 months to 5 years. However, the legal limits of imprisonment for the members of the management board, supervisory board, proxies or attorneys-in-fact of the issuer, its employees, qualified auditors, or other persons related to the issuer under any mandate contract or any legal relation of a similar nature are higher, from 6 months to 8 years.[244] It is interesting to note that the special aggravation of penalty of imprisonment concerns only those insiders mentioned by the Act of Parliament as belonging to the first group of insiders. The reason why the legislature decided to distinguish just some of the primary insiders by enumerating them in a more or less precise way seems to be unclear. The legislature probably did not want to impose the stricter responsibility on persons belonging to the first group but having only partial access to the issuer (like shareholders, stockbrokers or advisers).

For the offence of disclosing inside information, the Act of Parliament on Trading in Financial Instruments provides a financial penalty of up to PLN 2,000,000 (about EUR 500,000) and/or imprisonment of up to 3 years.[245] Finally, the same penalty is applied to the offence of issuing a recommendation or inducing another person on the basis of inside information to acquire or dispose of financial instruments to which such information relates.[246]

The fact that the Polish regulation does not provide any administrative sanctions for the above-mentioned breaches is based on the case-law of the Polish Constitutional Court. In many occasions, the Constitutional Court underlined the importance of respecting the principle of proportionality and considered that parallel application of administrative and criminal sanctions is unacceptable. It also stated that such a double prosecution exceeds the scope of regulation that is required in order to assure the proper respect for the provisions of the law.[247] In its judgments,

[244] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, Article 181.

[245] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, Article 180.

[246] Act of Parliament of 29 July 2005 on Trading in Financial Instruments, Article 182.

[247] See, e.g. judicial decisions of 29 April 1998 (No. of case K17/97) or of 4 September 2007 (No. of case P43/06); both of them were rendered in fiscal cases, however the general rule about unconstitutional application of administrative and criminal sanctions towards a single individual for the same breach can be applied to all domains.

the Constitutional Court did not pronounce on whether such regulation would be considered to violate the *ne bis in idem* principle, but relies on the functions of both kinds of penalties and the constitutional rule of the democratic rule of law. One of these rules is the principle of proportionality. Such an approach explains the introduction of the special explanatory proceeding before the KNF. In that way, there is no double (criminal and administrative) investigation: however the KNF has a possibility to collect some data required by the Market Abuse Directive and necessary to prepare a notification of a suspected offence for the prosecution.

The criminal responsibility introduced by the Polish regulation imposes on the prosecuting body additional obligations. The general rule of the Polish Criminal Code provides that, in order to be regarded as committing an offence, a person who commits a wrongful act must be characterised by guilt. Moreover, a forbidden act is not considered to constitute an offence if its social dangerousness is minimal.[248] In order to impose a criminal penalty a proof of guilt of a suspected person must be established as well as a proof of a social importance of the breach.

The Polish Criminal Code does not prefer any theory of guilt that should be applied.[249] In criminal law theory, the most popular approach combines both a possibility to blame somebody for the psychological attitude to the act and the violation of the rules binding an individual in a given situation.[250]

The notion of minimal social dangerousness is only vaguely defined in the Polish Criminal Code. The Code states that while analysing the social dangerousness the court must take into account the kind and character of a violated good, amount of caused or menacing damage, way and circumstances of the act, importance of the violated by an actor responsibilities, the kind of intent, motivation of actor, the kind of violated rules of prudence and the degree of their violation.[251] The law does not provide any strict thresholds to evaluate the level of the social dangerousness. Thus, it shall be always the task of the judge to analyse and assess this element of an offence.

The other important differences that are the results of the criminal – and not administrative – character of the proceeding in the insider dealing cases are the presence of the presumption of innocence, while in classical administrative procedure the issue of guilt is not relevant. The criminal proceeding requires proofs that are beyond a reasonable doubt while in the administrative proceeding, the mere preponderance of evidence is sufficient. Finally, in a criminal proceeding the

[248] Polish Criminal Code of 6 June 1997 (Journal of Law 1997, No. 88 item 553, as amended), Article 1.

[249] WĄSEK, Andrzej, KULIK, Marek, in: FILAR, Marian (ed.), *Kodeks Karny Komentarz*, 2nd edition, Lexis Nexis Warszawa 2010, p. 20.

[250] BOJARSKI, Tadeusz, *Komentarz do Kodeksu Karnego*, 3rd edition, Lexis Nexis Warsaw 2009, p. 28.

[251] Polish Criminal Code , Article 115 §2.

procedure is contradictory while in an administrative one there are just two parties: a participant (suspected insider) and the administrative authority.[252]

Although criminal law plays a crucial law in the prosecution of insider dealing under Polish regulation, there is still a place for the administrative law. It is applied to less significant breaches, such as not establishing of a list of persons having access to inside information or absence of notification to the KNF about any transactions executed by members of issuer's management or supervisory bodies.[253] It should be observed, however, that this shape of regulation does not comply with the wording of the Market Abuse Directive that requires application of administrative sanctions.[254] The Polish regulation is in principle similar to the one that was binding in Luxembourg before the amendment. Nevertheless, to the best of the author's knowledge, the European Commission has not yet communicated to Poland its reasoned opinion in this subject.

D Conclusions

The analysis of the method how four Member States implemented the Market Abuse Directive into their national legal systems shows how difficult it is to create the single European market. Although they were relying on the same text, in all of them the final result of transposition is different. Three of them (France, United Kingdom and, since recently, Luxembourg) have double – criminal and administrative – system of prosecution of insider dealing. In Poland, only criminal law is applied.[255]

A question might be asked on whether the transposition of the Market Abuse Directive in Poland (and initially in Luxembourg) was made properly. Article 14.1 of the Market Abuse Directive obliges the Member States to create appropriate administrative measures or administrative sanctions. The criminal sanctions are presented as an option. Meanwhile, the Polish legislatures based their regulation on criminal prosecution, i.e. using the most severe powers the state has. In consequence, according to the case-law of the Polish Constitutional Court, the administrative sanctions could not be applied.

On the other hand, the creation of the double system of prosecution, although approved by the Directive, evidently results in a system focused on punishment. The distinction between administrative and criminal prosecution is in practice irrelevant. In both proceedings, the burdensomeness of the penalties can be very

[252] CESR's Report on Administrative Measures and Sanctions as well as the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD), October 2007, p. 365.

[253] Act of Parliament on Trading in Financial Instruments, Articles 175 and 176.

[254] Market Abuse Directive, Article 14.

[255] Please see Annex 1 that summarises what kind of the legal definitions may be found in the analysed Member States.

high. And the objective is to impose a penalty in a criminal proceeding or, if this option was not possible, in an administrative one. Practice demonstrates that administrative sanctions applicable to persons who violate the insider dealing prohibition may be quite burdensome. One may wonder whether, in such situation, the application of additional criminal sanctions is necessary.

Another problem that the Member States faced while transposing the Market Abuse Directive derived from its ambiguity. In consequence, if they adopted the unchanged wording of the Directive's provisions their legal system risks being imprecise and unclear. But, it should be noted that in these Member States that decided to introduce any explanatory or additional clauses the scope of the prohibition has been changed, which leads to disparities between them.

Finally, the analysis demonstrates that the national tradition with regards to the combat against insider dealing influences the shape of the prohibition. Thus, very often the current shape of the prohibition, although based on the Directive, originates in the old regulations. This may result in disparities in wording of the rules governing the domain and, in consequence, provoke the discrepancies between the national jurisdictions.

In consequence, the transposition of the Market Abuse Directive has not reached its goal and has not fully uniformed the financial markets in this domain. As a result, the sample of four Member States shows that the shape of the insider dealing prohibition varies between different legislations and may result in different judicial decisions. Important disparities can be noticed in relation to practically all elements of the insider dealing: the notion of inside information, the determination of the moment when it becomes public, the scope of the insiders (particularly the primary insiders), and the definition of the forbidden behaviours. These notions differ between Member States but it should be underlined that they differ also within a single jurisdiction if only the applicable legal system provides in this domain both administrative and criminal sanctions. Differences between the criminal provisions applicable in different Member States do not arise directly from the Market Abuse Directive but they show that uniformity in this domain has not been achieved and may potentially provoke problems for persons alleged to be insiders violating the prohibition. These concerns may also be as violation of the basic principles of the law, like principle of legality that requires enactment of the precise rules that will be discussed in the next chapter.[256]

[256] Please see Sect. C.II, Chap. 3.

Chapter 3
Principles-Based Application of the Criminal Law

The expansion of criminal law that may be observed nowadays is very dynamic. It may be compared to a coasted bullet train. Meanwhile, one may wonder where this train is aiming to and whether the railway tracks are built on a solid basis. Otherwise, the passengers of the train are in danger and the destination to which they arrive may be different from the one expected.

In order to speak about the justified application of criminal law, some basic notions should be defined. As H.L.A. Hart noticed it, the issue of the proper justification of the use of criminal law includes an important question on what justifies the existence of a system that is in power to impose punishment on an individual.[1] It must be remembered that application of criminal law may lead to infliction of the harsh penalties (like liberty deprivation) and inevitably provokes limitation of the basic rights of its addressee.[2] Thus, the possibility to prosecute someone and inflict a punishment should be well funded. Therefore, it should be analysed what in fact the criminal law is and what distinguishes it from other branches of law. The last years' developments and extended (overextended?) use of criminal law have been provoking many doubts. Does this legislative activity comply with the rules that should govern the application of criminal law? What is the range of the behaviours that may be dealt with the help of this tool? Some authors even consider that there are no fixed boundaries to the content of the criminal law, and that it can be only distinguished form other branches of law on the basis of the different procedure applied to the criminal cases.[3]

[1] HART, H.L.A., *Punishment and Responsibility*, *Essays in the Philosophy of Law*, Oxford University Press, 2008, pp. 1–27.

[2] WRÓBEL, Włodzimierz, ZOLL, Andrzej, *Usprawiedliwienie karania (założenia systemu wymiaru kary w przyszłym kodeksie karnym),* in: STRZEMBOSZ, Adam (ed.), O prawo karne oparte na zasadach sprawiedliwości, prawach człowieka i miłosierdziu, Katolicki Uniwersytet Lubelski, 1988, p. 255.

[3] WILLIAMS, Glanville, *The Definition of Crime*, Current Legal Problems, 1955, p. 107, opinion presented in: ASHWORTH, Andrew, *Is the Criminal Law a Lost Cause*, Law Quarterly Review,

I. Seredyńska, *Insider Dealing and Criminal Law*,
DOI 10.1007/978-3-642-22857-5_3,

In this chapter, the issue of the proper use of the criminal law is examined. First, the basic notions are presented: what distinguishes criminal law from other branches of law, what are its objectives, what kind of values it is supposed to protect, when criminal law may or even should be applied. Then, the principles of criminalisation, i.e. the rules that determine the scope of justified use of the criminal law, are analysed. Most of them have been created as soon as the age of Enlightenment but still may still serve as a valuable tool in the domain of criminalisation. This examination aims at finding the arguments in support of the thesis that "[*i*]*t is right to resist the idea that the criminal law is not simply another tool that legislatures may use in order to further whatever purposes they wish to pursue*."[4]

Of course, even when relying on principles, one cannot elaborate a mathematical formula that would allow for the creation of the regulation based on criminal law or any other branch of law. But the principles may at least serve as "traffic signs" that would show the good direction and, most importantly, indicate where the legislature should not intervene.

The objective of this chapter is to advocate the principles-based approach to criminalisation as a guide for the legislature while considering introduction of a new rule. Otherwise the uniqueness of the criminal law is at risk, or, as Andrew Ashworth called it: "*the criminal law is likely to remain something of a lost cause*."[5]

Finally, the analysis of the reasons and principles of criminalisation enables us to reconsider the main issue of this thesis, i.e. the applicability of criminal law to fight with the stock exchange market behaviours like insider dealing.

A Criminal Law and Other Branches of Law

From time to time, the opinion can be heard that criminal law is not necessary for the proper functioning of the society and that it will disappear when an efficiently functioning political system will remove the sources of crime.[6] On the other hand, the visible expansion of criminal law, applied in order to regulate the new domains, demonstrates that the ideal political system has probably not yet been attained.

2000, Vol. 116, p. 226. Similar opinion in relation to the indefinable content of the criminal law expressed by Nicola LACEY in: LACEY, Nicola, *Contingency and Criminalisation*, in: Loveland, Ian (ed.), The Frontiers of Criminality. Sweet and Maxwell, London, 1995, pp. 1–27.

[4] ASHWORTH, Andrew, *Conceptions of Overcriminalization*, Ohio State Journal of Criminal Law, 2008, Vol. 5, p. 408.

[5] ASHWORTH, Andrew *Is the Criminal Law a Lost Cause*, Law Quarterly Review, 2000, Vol. 116, p. 226.

[6] E.g. Such an opinion, based on different grounds, is held by anarchists and Marxists. See: ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 17, ANDENÆS, Johannes, *The General Preventive Effects of Punishment*, University of Pennsylvania Law Review, 1966, Vol. 114, No. 7, p. 966.

In consequence, for the time being, and most probably for a long time to come, the discussion about the character and particular features of criminal law is and will be justified.

The discussion about the characteristics of criminal law may begin with the following definition: "*The central function of the criminal law may be thus described as [. . .] the declaration of the forms of wrongdoing that are [. . .] serious enough to justify [. . .] the public censure inherent in conviction and [. . .] punishment*."[7]

It should be underlined that the state may use many different legal and extra-legal tools such as civil and administrative law in order to fulfil its functions. Moreover, there are also spheres where the state's activity is not necessary and its intrusion may bring more harm than benefits. Such situation took place, for instance, in the states living under a communistic regime, where central planning of the market lead to the collapse of the whole economic system.

The application of civil law is justified in order to regulate the disparities between individuals, especially when a financial compensation is enough to resolve the dispute. Meanwhile, administrative law is applied towards the individuals and entities that are under control of the state and do not fulfil their obligations that are aiming at the proper functioning of a given domain of activity. Thus, the sanctions are inflicted on one that violates the order and creates a situation that may lead to violation of someone else's rights. The penalties that may be imposed in this kind of proceeding include financial fines or the withdrawal of the permission or license and may be of a very burdensome character for their addressee.[8]

In the discussion on the application of the criminal law many various justifications for its use are presented. There is no common opinion on the proper understanding of the notion of "serious enough wrongfulness". The only shared opinion is that criminal law regulates the most serious issues.[9] In spite of these disparities concerning the basis for application of the criminal law, there are hardly any doubts relating to its consequences. It is often underlined that the violation of criminal law rules results in the application of stigmatic sanctions.[10] It is the most invasive and intensive state's tool.[11] Moreover, only a conviction under criminal

[7] ASHWORTH, Andrew, *Conceptions of Overcriminalization*, Ohio State Journal of Criminal Law, 2008, Vol. 5, pp. 408–409.

[8] For more details see Chap. 4.

[9] E.g.: ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, pp. 37–42, CLARKSON, C.M.V., Keating, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 4, PACKER, Herbert L., *The Limits of the Criminal Sanction*, Stanford University Press 1968, pp. 262–264 in: CLARKSON, C.M.V., Keating, H.M., Criminal Law: Text and Materials, London Sweet & Maxwell, 2003, pp. 5–6.

[10] CLARKSON, C.M.V., Keating, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, pp. 1–2.

[11] LEVY, Thierry, *Y a-t-il encore une place pour la responsabilité pénale ?*, Pouvoirs 2002/1, No. 128, pp. 43–47.

law involves public censure, i.e. condemnation of the act and of the actor.[12] For these reasons the penalty of imprisonment may be inflicted only in criminal proceeding. Loss of liberty, even a short prison sentence, may be detrimental for the private and professional life of the incarcerated person. It usually involves humiliation and social stigma.[13] That is a reason why the criminal procedure is equipped with the guarantees that aim at the protection of the accused person against unfair treatment and penalty. Besides, it only confirms the thesis that criminal law should be applied with extreme caution.

It should be underlined that, even if, as a result of criminal proceeding, "only" pecuniary penalty is imposed, one is stigmatised by the declaration of being guilty of an offence. He is listed in a criminal record. Meanwhile, administrative penalty of the same character is not followed by a similar disapproval of the actor and does not have a similarly detrimental effect for his future. Similarly, the civil law verdict, even if it may reduce the level of trust that future co-contractors may have for its addressee does not usually have consequences on all spheres of one's life.

In spite of these differences, criminal law has been recently very often used by legislatures in many different states in order to deal with social problems. The subsequent sections attempt to present shortly how the application of the criminal law has been extended and what possible concerns this phenomenon may provoke.

I Traditional Application of Criminal Law

The vision of the cruel torture tools of the Middle Ages executioners should not blur the fact that the number of punished offences is much larger now than it was in the past.[14] The problem of the past centuries however, was that the punishment was imposed very often discretionarily and that there were no clear rules that determined the shape of the law and of the sanctions that could be applied to particular cases.

The development of the modern criminal law theory is one of the main achievements of the age of Enlightenment. The philosophers analysed the basic individual rights and the principles of law that have to be respected in order to assure that one's rights are not violated. The considerations about the nature of crime and punishment and, most importantly, about the rights of individual and the limits of law,[15] developed afterwards in subsequent centuries, helped to determine

[12] Among others: FEINBERG, Joel, *The Expressive Function of Punishment*, The Monist, Vol. 49, No. 3, 1965, p. 397, PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 39.

[13] Similarily: JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio)*, Ohio State Journal of Criminal Law, 2005, Vol. 2, p. 526.

[14] SÓJKA-ZIELIŃSKA, Katarzyna, *Historia prawa*, Warszawa, 1997, p. 155 ff.

[15] See: LOCKE, John, *Two Treatises of Government*, available at http://www.efm.bris.ac.uk/het/locke/government.pdf, BECCARIA, Cesare, *On Crimes and Punishments and Other Writings*, Ed.

the proper limits of criminal law and to indicate its main objective. According to the philosophers of the age of Enlightenment, criminal law could be applied only in case of violation of the natural human rights such as the rights to life, freedom, personal property.[16] Moreover, they distinguished the principles that should be respected for the proper enactment and application of the law.

It should be noted that the philosophical trend aiming at the limitation and the principles-based application of criminal law has been accompanied by opposite theories that wanted to increase the powers of the state and to justify a wide application of this branch of law.[17] It was a consequence of different cornerstones on which the competitive theories were built. They were concentrating not on personal freedoms but on the state's power and on a justification for its intervention into individuals' lives. In result, they allowed the state's intervention whenever the legislature considered it to be appropriate.

II New Domains of the Application of Criminal Law

The analysis of the new criminal regulations demonstrates that the distinction between criminal law and other branches of law is blurred. Although it is still underlined that criminal law is the severest state reaction for an undesired behaviour,[18] the objectives of its application have changed. In consequence, criminal law is applied beyond its classical boundaries. This process is especially visible in the domain of commercial law and market activity regulation. New goals, created in order to justify the state's intervention, replaced the traditional objectives of the criminal law. For instance, some authors express the opinion that the objective of criminal law applied in the domain of the commercial activity is the protection of the business transactions.[19] It may be easily observed that the principles of the age of Enlightenment have been forgotten. But it seems also that there is not any coherent theory that could replace them.

Richard Bellamy, Cambridge University Press, 1995, ROUSSEAU, Jean-Jacques, *Du contrat social, ou, principes du droit politique,* Paris : Garnier Frères, 1962, MILL, John Stuart, *On Liberty*, Batoche Books, Kitchener, 2001, MONTESQUIEU, Charles de Secondat, *The Spirit of Laws*, Kitchener, 2001.

[16] See the emanation of this philosophy in the Declaration of the Rights of the Man and of the Citizen, 1789.

[17] See, e.g. Sect. C.I.3 of this chapter on the *Rechtsgut* theory.

[18] NESTORUK, Igor B., *Zasada ultima ratio na przykładzie niemieckiego prawa karnego*, in: DUKIET – NAGÓRSKA, Teresa (ed.), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, p. 25, JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio),* Ohio State Journal of Criminal Law, 2005, Vol. 2, p. 526.

[19] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 39.

The authors that want to establish the new limits of application of criminal law underline that criminal law should be used when punishment is in the interest of the whole community because the wrongful act violates the most essential or basic community's values.[20] The problem is that such an approach does not give an answer when the act becomes "public enough" to justify the application of criminal law. It may be claimed that an unreliable debtor who does not fulfil his obligations arising from a civil contract also hurts the whole community because he undermines the trust people usually have for entered into deeds. However, it is considered to be a civil wrong and it depends on the creditor's will whether he decides to launch the civil lawsuit to force his debtor to pay or not.

In the second half of the twentieth century, an attempt to regulate many market behaviours with the help of criminal law could be observed. Before that, commercial issues were regulated by civil law or were simply considered to fall outside the scope of the state's powers of regulation. Currently, the need of the state's intervention in order to prosecute wrongful financial transactions, such as money laundering was ascertained on the European Union level. In consequence, new criminal regulations were introduced to the national legal orders.

Moreover, also from a formal point of view, the distinction between criminal law and other branches of law have been infringed. A classical criminal regulation can be found in a criminal code. Meanwhile, in many countries, new criminal regulations have been introduced by new specialised criminal laws or by adding criminal provisions to the acts that regulate various domains of human activity. For example, in France and in Poland, the criminal prohibition of insider dealing was introduced to the acts of parliament governing the market activity. In Luxembourg the same behaviour is forbidden by a separate law.[21] A similar approach was taken towards criminalisation of the other market offences.[22]

Naturally, criminalisation undertaken in such a way does not violate any technical rules concerning the enactment of new criminal laws. However, it should be kept in mind that one of the principles of a properly passed law is its publicity. This rule is especially important in the domain of criminal law. Everyone should have a possibility to learn easily about the rules whose violation may lead to a criminal prosecution. Thus, one can observe the rise of the postulate of the gathering all criminal rules in one act, widely accessible and publicly known as "an encyclopaedia of the criminal prohibitions", i.e. the criminal code. The other solutions, unfortunately used by many national legislatures, create a situation in

[20] DUFF, Anthony, *Answering for Crime*. Oxford: Hart Publishing, 2007, chapter 5.

[21] For more details see Sect. B, Chap. 2.

[22] E.g. in Poland, criminalization of money laundering in Act of Parliament of 16 November 2000 on Counteracting Money Laundering and Terrorism Financing (*Ustawa z dnia 16 listopada 2000 r. o przeciwdziałaniu wprowadzaniu do obrotu finansowego wartości majątkowych pochodzących z nielegalnych lub nieujawnionych źródeł oraz o przeciwdziałaniu finansowaniu terroryzmu*) published in Dz.U. 2003, No. 153, item 1505, as amended.

which one may have difficulties to learn about all binding criminal regulations.[23] Moreover, although formally there is no distinction between codes and other acts of parliament, the legislature is more reluctant to modify the provisions of a code than the provisions of an act of another kind. Hence, the introduction of criminal provisions into the criminal code bolsters the respect of the principle of stability of criminal law.[24]

The next important change in the domain of criminal law is the scope of its addressees. It is not only an individual any more. Criminal regulations have been applied to prosecute legal entities. It is a symptom confirming the observation that the boundaries between criminal and administrative law have been at least partially abolished. The application of one or another of these legal systems is made without profound consideration, as if one was an equivalent of another. It is partly based on the fact that one of the most important administrative sanctions, i.e. the financial penalty, does not differ a lot from the criminal fine. Meanwhile, it is forgotten that the procedure in which it is imposed is completely different, has other objectives and other principles that govern it. The increasing application of criminal law outside its traditional scope, in order to control the behaviours that were usually ruled by the administrative law, blurred the division. On the one hand the criminal law is applied to situations governed by administrative law. On the other hand, sanctions inflicted in administrative proceedings are so burdensome that some specialists speak already about a new administrative-criminal law.[25] For that reason, the ECHR created an autonomous definition of the notion of "criminal" and stated that the guarantees stated in Article 6 of the ECoHR should be applied not only to all the proceedings that are defined by the domestic law as "criminal", but also to other kinds of proceedings if "the nature of the offence" justifies it and when the severe penalties may be imposed.[26]

Finally, numerous criminal rules are enacted as a result of political action or pressure exerted by lobbies. All this phenomena lead some legal specialists to worry that legal systems are facing the issue of overcriminalisation.

In the subsections below these issues will be briefly presented.

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[23] Similarly: ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 265.

[24] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 265, on importance of stability see: WRÓBEL, Włodzimierz, *Drogi i bezdroża prawa karnego (o rządowym projekcie nowelizacji kodeksu karnego)*, Państwo i Prawo 2007, No. 9, pp. 3–13.

[25] SZUMIŁO – KULCZYCKA, Dobrosława, *Prawo administracyjno – karne, czy nowa dziedzina prawa?*, Państwo i Prawo, 2004, No. 3, pp. 3–16.

[26] *Engel and Others v. The Netherlands,* judgment of 8 June 1976, Series A no. 22, *Öztürk v. Germany,* judgment of 21 February 1984, Series A no. 73, for more details see: EMMERSON, Ben, ASHWORTH, Andrew, MACDONALD, Alison, *Human Rights and Criminal Justice*, London Sweet&Maxwell, 2007, pp. 191–235.

1 Application of Criminal Law to Legal Entities

Application of criminal sanctions in order to punish legal entities is one of the examples of administrative-like thinking about criminal law. According to the principles of criminal law, individual culpability is one of the crucial elements of criminal liability. In the case of the legal entities' liability, one can only speak about "collective culpability". However, the application of the strictly individual notion of culpability to the group of persons is an oxymoron and is reminiscent of the worst experiences of the twentieth century. Besides, sanctions inflicted on legal entities in such a proceeding are of an administrative character (financial penalties, withdrawal of the licence[27]). Their imposition in a criminal proceeding is supposed to upgrade the rank of the punishment. A question might be asked on whether, instead of increasing the rank of the penalty, such a way of dealing with an unwanted behaviour, does not demote the criminal law.

The issue of corporate criminal liability had been discussed already in the nineteenth century. In those times, referring to the fundamental notions of the criminal law, Friedrich Carl von Savigny stated: "*Criminal law has to do with natural persons as thinking and feeling persons exercising their free will. A legal person however is not such a person, but merely a property owning being, [. . .] with its reality based on the representative will of certain individual persons, which, by way of fiction, is attributed to its own will. Such a representation [. . .] can be acknowledged everywhere in civil law, but never in criminal law. Everything which is considered as a legal person's crime is always only the crime of its members or organs, this means of single human beings or natural persons. [. . .] If a legal person were to be punished for a crime, the basic principle of criminal law, the identity of the offender and of the sentenced person, would be violated.*"[28] Since then, nothing has changed in the domain of the principles of criminal law and still many legal specialists find this construction at least controversial.[29] The defendants of the corporate criminal liability refer mainly to extra-legal arguments. The most popular of them is that it is much easier to impose penalty on a legal entity (especially a big one that possesses important assets) than find a guilty individual

[27] See e.g. Polish regulation on corporate criminal liability: Act of Parliament of 28 October 2002 on Liability of the Collective Entities for the Acts Prohibited under Penalty (*Ustawa z 28 października 2002 r. o odpowiedzialności podmiotów zbiorowych za czyny zabronione pod groźbą kary*) published in Dz. U. 2002, No. 197, item 1661, as amended.

[28] von SAVIGNY Friedrich Carl, *System of Roman Law*, 1840 cited in: MÖHRENSCHLAGER, Manfred. *Development on an International Level*, p. 1. Paper presented at the *International Colloquium on Criminal Responsibility of Legal and Collective Entities*. 4-6 May 1998, Berlin.

[29] ALSCHULER, Albert W., *Two Ways to Think About the Punishment of Corporations*, American Criminal Law Review, 2009, Vol. 46, pp. 1359–1392, ARLEN Jennifer, KRAAKMAN, Reinier, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes,* New York University Law Review, 1997, Vol. 72, pp. 687–779, KADISH, Stanford H., *Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations,* The University of Chicago Law Review, 1963, Vol. 30, pp. 430–435.

within it.[30] Thus, the practical conditions prevail in their opinion over the fundamentals of criminal law.

It should be noted that the Market Abuse Directive applies both to individuals and legal entities. Moreover, in its permission to introduce criminal sanctions to regulate the issue, it does not make any difference between natural and legal persons. In consequence, all the concerns presented above also apply, at least indirectly, to the Market Abuse Directive.

2 Overlapping of Criminal and Other Branches of Law

In some situations criminal law is considered to be an equivalent for other legal tools. The example of insider dealing demonstrates that it may be used instead of civil law regulation. When it comes to administrative law, the issue of the mutual relations between criminal and administrative law may be understood twofold. First, for part of the legal specialists, the distinction between criminal and administrative law seems to disappear. In consequence they regard the application of criminal law as an administrative tool. The second concern relates to application of both criminal and administrative sanctions in order to punish a single act.

a) Application of Criminal Law as a Civil Law Tool

When the principles of proper criminalisation are not respected, criminal law can be applied as an administrative technique that imposes the costs of enforcement on the whole society and not only on victims. It serves simply as an alternative to other legal means, and is applied in a situation when there are no victims of given behaviour and application of civil law would be fruitless because there would be no individuals interested in private enforcement.[31] Such an approach can be also found in the criminalisation of insider dealing. As it was shown in the presentation of economic analyses of insider dealing,[32] the issue of who is victimised by insider dealing is controversial and it is difficult to indicate the individual – victims of this behaviour. Thus, in many cases, no one would be interested in suing insiders that undertake their trades. This might be caused by the small amount of alleged loses or even unawareness that insider's deals could provoke any. Therefore, states are trying to administer justice on their own by regulating the behaviour and expressing their condemnation for it.

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[30] BEALE, Sara Sun, *A Response to the Critics of Corporate Criminal Liability*, American Criminal Law Review 2009, Vol. 46, pp. 1481–1505.

[31] Some authors do not see anything wrong in such application of criminal law, e.g. see BALL, Harry V., FRIEDMAN, Lawrence M., *The Use of Criminal Sanctions in the Enforcement of Economic Legislation: A Sociological View*, Stanford Law Review, 1965, Vol. 17, No. 2, p. 214.

[32] Part II of the Chap. 2.

b) Criminal-Administrative Law

The increasing importance of the application of administrative prosecution and increasing administrative penalties create, in the opinion of some authors, a basis for a new branch of law, namely the criminal-administrative law.[33] Although administrative authorities cannot impose the most punitive penalty of the criminal law, i.e. imprisonment, the pecuniary penalties they may inflict can be of such importance that the difference between penalties imposed in criminal and in administrative proceeding blurs. But it should be underlined that similar penalties do not mean similar procedures and similar guarantees for the sentenced person. Thus, talking about such a hybrid branch a law while relying only on the dimension of the penalty seems to be unfounded.

c) Parallel Application of Criminal and Administrative Law

The *ne bis in idem* principle assumes that no one can be prosecuted and punished twice for the same offence.[34] Its objective is to protect an individual against the abuse by a state of its powers and to assure that, once sentenced or acquitted, one is sure that no new state's decisions would be issued in the same case.[35] Initially this rule was applied to the acts prosecuted at the national level and limited the powers of a national court what a given wrongful act had been already judged by another competent judicial body.

The respect for this rule is much more difficult when it relates to an offence that violates the criminal regulations of different states. Such a situation may naturally arise in case of insider dealing when it relates to financial instruments listed on the stock exchanges located all over the world or when the acquisition of inside information, the decision about conducting the deal, and the transaction itself are undertaken under distinct jurisdictions. Because of the international character of the financial markets, such a situation is possible not only in theory.

In the domain of criminal law the *ne bis in idem* principle was officially accepted as a rule binding all European Union Member States in Article 54 of the Convention Implementing the Schengen Agreement.[36] Moreover, the rule was confirmed in

[33] SZUMIŁO – KULCZYCKA, Dobrosława, *Prawo administracyjno – karne, czy nowa dziedzina prawa?,* Państwo i Prawo, 2004, No. 3, pp. 3–16, SPIELMANN, Dean, SPIELMANN Alphonse, *Droit pénal général luxembourgeois*, Bruylant Bruxelles, 2004, p. 364.

[34] WASMEIER, Martin*, The Principle of Ne Bis in Idem,* Revue internationale de droit pénal, 2006, Vol. 77, p. 121.

[35] LIGETI, Katalin, *Rules on the Application of ne bis in idem in the EU – Is Further Legislative Action Required?,* Eucrim, 1-2/2009, p. 37.

[36] O.J. L239/19, [2000]: "A person whose trial has been finally disposed of in one Contracting Party may not be prosecuted in another Contracting Party for the same acts provided that, if a penalty has been imposed, it has been enforced, is actually in the process of being enforced or can no longer be enforced under the laws of the sentencing Contracting Party."

Article 50 of the Charter of Fundamental Rights of the European Union. It assumes a high level of trust of the national jurisdictions for the legal systems of the other Member States.[37]

The CJEU has already had a chance to analyse the issue of how to apply this principle properly. According to the CJEU case-law, on the European level the *ne bis in idem* principle has to be complied with also in cases when one of the competing proceedings is conducted by the prosecution and finished by a decision of a prosecutor about the imposition of a penalty, because such a termination of the proceeding causes the whole procedure to be finally disposed of.[38] The CJEU developed its statement in the *Miraglia* case[39] where it specified that the *ne bis in idem* principle does not apply when one of the judicial (or prosecutorial) decisions closes the proceeding only because the existence of the parallel proceeding in another Member State, without analysing any merits of the case. Moreover, in the *Gasparini* ruling[40] the CJEU accepted the application of the principle when the accused was acquitted because of the fact that the prosecution of the offence was time-barred.

In the domain of insider dealing a question may be asked on whether the same rule could be applied to administrative proceedings and the imposition of administrative measures. What should be their relation to the criminal proceeding conducted simultaneously in the same state or other Member States? The prohibition of double punishment and prosecution established by the *ne bis in idem* principle does apply only to the criminal law sphere.[41] The situation created by the Market Abuse Directive presupposes the existence of administrative measures applied to insider dealing but also promotes the introduction of criminal regulations. And in many Member States, the system of parallel criminal and administrative sanctions exists. In such a way, an individual may potentially face double (administrative and criminal) punishment in one Member State, as well as violate both administrative and criminal regulations of other Member States of the European Union.[42] The principles expressed by the CJEU's case-law do not apply to this situation, as the judgments relate only to the issue of double prosecution within the scope of the criminal law. Meanwhile, although in the administrative proceeding there is no possibility to limit someone's freedom by his imprisonment, the financial penalties applied in administrative proceeding do not differ

[37] LIGETI, Katalin, *Rules on the Application of ne bis in idem in the EU – Is Further Legislative Action Required?,* Eucrim, 1-2/2009, p. 38.

[38] CJEU, 11 February 2003, joined cases *Hüseyin Gözütok*, C-187/01, and *Klaus Brügge*, C-385/01.

[39] CJEU, 10 March 2005, *Miraglia*, C-469/03.

[40] CJEU, 28 September 2006, *Gasparini*, C-467/04.

[41] LIGETI, Katalin, *Rules on the Application of the ne bis in idem in the EU – Is Further Legislative Action Required?,* Eucrim, 1-2/2009, p. 37.

[42] See the examples of the national transpositions of the Market Abuse Directive to the national orders of the Member States in Chap. 2.

importantly from those imposed in a criminal one. But still, the *ne bis in idem* principle is not applicable.

It should be observed, however, that the ECHR, through its case-law proposed an interpretation of Article 6 of the European Convention on Human Rights that extends the scope of the application of the *ne bis in idem* principle. It was made through the creation of a notion of "criminal charge" that is independent from the categorisation used by the national legal systems of the Member States and has an autonomous meaning.[43] It stated that a proceeding should be qualified as criminal and it should enjoy the protection assured by Article 6 of the European Convention on Human Rights (hereinafter referred to as the "ECoHR") if (1) it is so classified by the domestic law, (2) the nature of the offence indicates so or (3) the person concerned risks incurring potentially severe penalties.[44] In consequence, on the basis, especially, of the third precondition, many administrative proceeding should be treated as criminal. Such a qualification would prohibit the application of a double criminal and administrative prosecution for a single act. But it seems that the qualification of criminal charge proposed by the ECHR was not widely accepted even by the states that signed the ECoHR. In practice, it has not influenced the national legal systems. Parallel application of both criminal and administrative sanctions to the same acts may be found in many national jurisdictions.

3 New Domains of Regulation

As it was mentioned above, criminal law is used now as a regulatory tool in order to deal with new social phenomena, especially in the market activity domain. An example of these changes can be found in the modifications introduced to the Polish Criminal Code already in 1969. The old criminal code of 1932 provided only for protection of the creditors (thus, natural persons or entities) against wrongful behaviour of their debtors (that aimed at their impoverishment).[45] Introduction of a new criminal code in the 1960s of the twentieth century changed the scope of interests of the criminal law. Namely, the abstract notion of the protection of the market and business transactions was introduced.[46]

Since then, the trend aiming to protect general concepts instead of protection of natural persons has been developing. The insider dealing prohibition is not the only

[43] *Adolf v. Austria*, judgment of 26 March 1982, Series A no. 49, § 30.

[44] *Engel and Others v. The Netherlands*, judgment of 8 June 1976, Series A no. 22, § 82–83.

[45] Articles 273–285 of the Order of the President of the Republic of Poland of 11 July 1932 - Criminal Code (*Rozporządzenie Prezydenta Rzeczypospolitej z dnia 11 lipca 1932 r. - Kodeks karny*) published in Dz.U. 1932, No. 60, item 571.

[46] Articles 217–223 of the Act of Parliament of 19 April 1969 Criminal Code *(Ustawa z dnia 19 kwietnia 1969 r. Kodeks karny)*, published in Dz.U. 1969 No. 13, item 94. A question may be asked on whether such a formulation in a communistic state was not based on a will of legislature to extend the powers of prosecution to interfere into individuals' lives.

example of the application of criminal law to regulate the market. Criminalisation of money laundering also belongs to this trend.

Besides, the widening range of application of criminal law is accompanied by incentives to increase the powers of control exercised by different governing bodies. The creation of the offence of abuse of the European Union funds and establishment of the new entity that may lead the survey alongside with the national prosecutors clearly demonstrates this tendency.

a) Money Laundering

The need to apply criminal law prosecution and sanctions to money laundering, i.e. transactions aiming at concealing the origins of the property derived from the criminal activity, had been already ascertained at the beginning of the 1990s of the twentieth century in the Directive 91/308/EEC.[47]

Although that directive was replaced with a new Directive 2005/60/EC,[48] it has not changed the approach towards the acts of money laundering. The previous formulations that directly indicated the need to criminalise the conduct[49] were replaced by the same formulation as may be found in the Market Abuse Directive: it imposes administrative regulation but declares that criminal sanctions may also be used at the national level to deal with the issue.[50]

It should be noted that the criminalisation of money laundering is considered to be an element of the fight against terrorism. Putting aside the concerns that emerged from the efforts to properly define the notion of terrorism,[51] one may observe that criminal law is applied here as an element of protection of the "*soundness, integrity and stability of credit and financial institutions and confidence in the financial system as a whole*".[52] It demonstrates that the scope of the protection assured by criminal law has extended importantly. And it confirms the thesis that criminal law

[47] Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, Official Journal L 166 of 28.06.1991, see also: KOWALIK-BAŃCZYK, Krystyna, *Wpływ prawa wspólnotowego na stosowanie krajowego prawa karnego*, Studia Europejskie, 2006, No. 3, pp. 99–127.

[48] Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, OJ L 309, 25.11.2005, p. 15–36.

[49] "Whereas money laundering must be combated mainly by penal means", Directive 91/308/EEC, recital 4.

[50] Directive 2005/60/EC, Article 39.2.

[51] For details see, e.g.: SAUL, Ben, *Attempts to Define 'Terrorism' in International Law*, Netherlands International Law Review, 2005, Vol. 52, No. 1, pp. 57–83 and cited there articles.

[52] Directive 2005/60/EC, recital (2).

is used to deal with issues that are only auxiliary to the main issue (in this case the illegal actions that allow to enter into possession of "laundered" assets).[53]

b) Abuse of the European Union Funds

Protection of the financial interests of the European Union has become one of the fundaments of the implementation of the European Union objectives. For this purpose, both national and European level authorities were mobilised.

On the European level, the European Anti-Fraud Office (hereinafter referred to as the "OLAF") was created in 1999 and the European Commission conferred on it tasks related to the fight against any illegal activities affecting the financial interests of the European Union.[54] Meanwhile, Article 325 of the TFEU (previously Article 380 of the Treaty establishing the European Community) imposes on the Member States an obligation to take the same measures to counter fraud affecting the financial interests of the European Union as they take to counter fraud affecting their own financial interests. It means that if a Member State applies criminal law to protect its own budget, it should apply it to protect European funds, too. Moreover, the application of the national law does not limit the possibility to apply administrative penalties on the European level. The Council Regulation No. 2966/95[55] provides that in case when criminal proceeding is launched on the national level administrative penalties cannot be imposed until it finishes. Afterwards, "[*w*]*hen the criminal proceedings are concluded, the suspended administrative proceedings shall be resumed, unless that is precluded by general legal principles*."[56] As it was said above, according to the Charter of Fundamental Rights of the European Union, the principle of *ne bis in idem* does not apply to the combination of criminal and administrative proceedings. Thus, one (i.e. an individual or a legal entity) may face two proceedings on both national and European levels.

It also should be noted, that to the OLAF was granted many different powers not necessarily linked to the protection of the European financial interests. Naturally, the OLAF's mandate covers in principle all revenues and expenditures of the European Union, including the general budget, budgets administered by the European Union or on their behalf and certain funds not covered by the budget, administered by the European Union agencies for their own account. But it covers also other, non-financial interests, and "*concerns all activities designed to*

[53] For more on this issue see: HUSAK, Douglas, *Overcriminalization: The Limits of the Criminal Law*, Oxford University Press, 2008.

[54] Commission Decision of 28 April 1999 establishing the European Anti-Fraud Office (OLAF), OJ L 136, 31.05.1999, pp. 20–22.

[55] Council Regulation No. 2988/95 of 18 December 1995 on the protection of the European Communities' financial interests (also known as the 'PIF' Regulation), OJ 1995 L 312, 23.12.1995, pp. 1–4.

[56] Council Regulation n° 2988/95, Article 6.3.

safeguard European Union interests against serious irregularities liable to lead to administrative or criminal proceedings, including investigations in areas other than the protection of the European Union's financial interests".[57] Thus, a legal entity was created that is entitled to lead investigations in many domains and its powers are not limited by the main objective of its establishment.

Moreover, its activity overlaps the activity of national controlling bodies. Two parallel inquiries may be conducted: one on the national level and one on the European one. In consequence, it may be justifiable assumed that the creation of the OLAF was a result of a lack of trust of European institutions for the states' national mechanisms and doubts may arise on whether the principle of subsidiarity, one of the foundations of the European law, was in this case applied properly.

III Overcriminalisation

Extensive application of criminal law initialised a discussion on the so-called "overcriminalisation phenomenon", i.e. the overuse of criminal law.[58] The notion of overcriminalisation includes various issues. It is applied to describe the criminal regulations in which the law provides excessive punishment, overlapping scope of the different criminal regulations, extension of the criminal law to acts committed without element of culpability (strict liability offences).[59] Among them, one of the most important concerns is the application of criminal law in order to regulate various, unwelcomed by the society behaviours. It may be observed that the notion of overcriminalisation is applied to different domains of illegal activity, like sexual behaviours or narcotic use.[60] Unsurprisingly, the fast-developing sphere of white-collar-crime can be found is also on the list.[61]

Not all authors consider that overcriminalisation is a real problem that requires any remedies. According to some of them, one cannot speak about overcriminalisation because it is impossible to delimit the proper scope of application of criminal law and, in consequence, it is impossible to state when its use is

[57] OLAF's Manual Operational Procedures, 1 December 2009, p. 15, available on: http://ec.europa.eu/dgs/olaf/legal/manual/OLAF-Manual-Operational-Procedures.pdf (last visited on 13 September 2010).

[58] ASHWORTH, Andrew, *Conceptions of Overcriminalization*, Ohio State Journal of Criminal Law, 2008, Vol. 5, p. 407.

[59] For more details see: LUNA, Erik, The Overcriminalization Phenomenon, American University Law Review, 2005, Vol. 54, p. 716.

[60] ASHWORTH, Andrew, Conceptions of Overcriminalization, Ohio State Journal of Criminal Law, 2008, Vol. 5, p. 407.

[61] ROSENFELD, Emmanuel, VEIL, Jean, *Sanctions administratives, sanctions pénales*, Pouvoirs 2009/1, no. 123, p. 68.

excessive.[62] Such an approach opens a gate for a legislature and allows him to intervene whenever he finds it justified. Other authors observe that application of criminal law decreased during the last century.[63] This statement tries to undermine the claim of overcriminalisation. One must agree that during the twentieth century, some offences based on moral premises were decriminalised (e.g. homosexual behaviour). However, the same observation cannot be applied to the white-collar-crime domain, whose scope has importantly extended during the last decades. Finally, a group of authors considers that criminal law is applied excessively and proposes their own thesis about the reasons of overcriminalisation and possible remedies.[64]

There may be distinguished two distinct, although interconnected, basic reasons for overcriminalisation. First, as it was presented above, criminal law "merged" with administrative law and is often applied as its equivalent. Secondly, and this aspect will be described in the two next subsections, criminal law became a tool in the hands of politicians and other groups that aim at strengthening their career and popularity in the society.

1 Political Actions

"*Laws are like sausages, if one wants to continue trusting them it should never find out how they are made*."[65] It might be a harsh statement but it reveals the fact that not only principles-oriented approach is taken while new rules are enacted. From a political point of view, a new criminal statute can be introduced "effortlessly" into the national legal system. Its enactment does not entail the imminent budgetary costs because the application of a new law enters into the scope of the activity of

[62] LACEY, Nicola, *Historicising Criminalisation: Conceptual and Empirical Issues*, The Modern Law Review, 2009, vol. 72, No. 6, pp. 936–960, LACEY, Nicola, *Contingency and Criminalisation* in: Loveland (ed.), Frontiers of Criminality, 1995, opinion presented in: CLARKSON, C.M.V., KEATING, H.M., Criminal Law: Text and Materials, London Sweet & Maxwell, 2003, p. 3.

[63] BROWN, Darryl K., *Rethinking Overcriminalization*, 2006, bepress Legal Series, paper 995, p. 22.

[64] KADISH, Sanford H., *The Crisis of Overcriminalization*, Annals of the American Academy of Political and Social Science, 1967, Vo. 374 Combatting Crime, pp. 157–170, LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, pp. 703–743, HUSAK, Douglas, *Overcriminalization: The Limits of the Criminal Law*, New York, Oxford University Press 2008 and other presented there authors.

[65] ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 35, available through: www.ecgi.org/wp, the author does not makes any reference to the author of this proverb. Usually it is attributed to Otto von Bismarck however the oldest reference to the "law and sausage" may be found in The Daily Cleveland Herald of 29 March 1869 where the lawyer-poet John Godfrey Saxe is cited (SHAPIRO, Fred R., *On language Quote. . .Misquote*, The New York Times, 21 July 2008 available on: http://www.nytimes.com/2008/07/21/magazine/27wwwl-guestsafire-t.html?_r=1 (last seen on 3 November 2010)).

already existing structures. Moreover, in a popular opinion, the application of criminal law "*demonstrate[s] a [government's] toughness against crime*".[66] An opinion may be defended that this way of dealing with social concerns has only positive sides. Especially, such a position may be supported if one accepts that there is no unifying thread that could define the content of criminal law[67] and that it may be applied to demonstrate (at least in theory) the effectiveness of the government.

In consequence, many (or even most) criminal regulations are introduced into national legal systems under the influence of public opinion,[68] i.e. just for political reasons in order to gain popularity or public approval. This kind of political actions was especially visible in the United States of America after the terrorist attacks in September 2001 and, afterwards, in other parts of the world. The political pressure to deal with the problem and to calm the social worries led to the introduction of new laws that allowed the state's authorities to exercise much stronger control over the members of the society. But even a local occurring, a tragic accident or brutal behaviour may launch a discussion on the need to introduce a new criminal measure. The pressure of media and public opinion after a violent crime may be a sufficient reason to introduce a new much harsher criminal regulation.[69] When such a social need of criminalisation arises, the politicians very seldom consult the specialists or ask for more detailed research in order to avoid public dissatisfaction or criticism.[70]

Besides, the argument of increased criminal punishment is quite often used during the elections in order to get additional votes. Meanwhile, the propositions to decriminalise or reduce punishments do not seem to be so popular.[71] From a pragmatic scope of view such a political behaviour does not surprise. Legislative initiatives in democratic societies are usually made in order to gain popularity. Finally, people who vote decide about the results of elections and politicians who do not understand it may end their career very fast (at the next elections). In fact, only a tyrant may enact the acts without taking into account the opinion of the nation who is under his reign.[72]

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[66] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 3.

[67] LACEY, Nicola, *Contingency and Criminalisation* in: Loveland(ed.), Frontiers of Criminality, 1995, opinion presented in: CLARKSON, C.M.V., KEATING, H.M., Criminal Law: Text and Materials, London Sweet & Maxwell, 2003, p. 3.

[68] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 3.

[69] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 718 and the examples cited in the footnote no. 83.

[70] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 25.

[71] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 718.

[72] Similar observations: ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 3, available through: www.ecgi.org/wp.

From a political point of view, criminal law may be used as a "communication medium"[73] through which the politicians "send [. . .] out a symbolic message"[74] to their potential electors about the legislative activity. The enactment of a new criminal law shows their disapproval and their will to deal with the problem. But is has nothing to do with the proper use of the criminal law. Generally, politicians do not take into account the other possible consequences of criminal law's "over-use", such as the decrease of the respect for this branch of law, but only the short-term benefits arising from demonstration of the willingness to deal with the issue.

Pretending that "something has been done" to deal with an important social problem applies not only to political actions on a national level. Criminalisation is also used as a tool in political actions undertaken on the international level.[75] Many new criminal regulations were enacted on a national level in order to fulfil the requirements of the European Union legislative acts. For instance, regulation of insider dealing was introduced into national legal systems of many Member States only after the enactment of the Insider Dealing Directive.[76] In such a way new, criminal rules are the result of the administrative actions of the European bureaucrats.[77] This, of course, raises the issue of their democratic legitimacy and conformity with principles of criminalisation. Obviously, on the national level, introduction of a new criminal rule just because of an international assignment does not justify the need of criminalisation. Nevertheless, other explanations are rarely given.

Concentration on the political goals may be noticed in the domain of white-collar crimes regulations. As it was mentioned in Chapter 1, for many people, activity of people on the stock exchange is incomprehensible. In consequence, any profit a market player makes is, by definition, morally doubtful. Such a common opinion may encourage some politicians who want to gain public applause. All that do not trust the stock exchange would welcome introduction of a regulation that limits someone else's profits. That was the reason why the common opinion about "corporate greed",[78] strengthened suggestively in popular films,[79] led in the

[73] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, p. 74 (emphasis omitted).

[74] ASHWORTH, Andrew, *Is the Criminal Law a Lost Cause*, Law Quarterly Review, 2000, Vol. 116, p. 253.

[75] See, e.g. *La dépénalisation de la vie des affaire*s, Rapport au garde des Sceaux, ministre de la Justice, prepared by a working group chaired by Jean-Marie COULON, January 2008, where on p. 21 this issue is discussed on an example of France.

[76] See an example of Luxembourg (Sect. B.II., Chap. 2).

[77] Similar concerns: ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, pp. 44–45.

[78] LUNA, Erik, *The Overcriminalization Phenomenon*, 2005, American University Law Review, Vol. 54, p. 721.

[79] E.g. Wall Street, 20th Century Fox, 1987, mentioned, inter alia, in: LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 730.

1980s of the twentieth century to the criminalisation or harsher approach of the authorities towards the insider dealing.

As it was presented above, political criminalisation concentrates on the political effects of enactment of the new statutes and not on the principles of criminal law. In consequence, the legitimacy of the new criminal rules derives from the fact that they are enacted by a democratic entity and, on this basis, should be respected.[80] Such an approach reflects the legal positivism theory in its "purest" version. But it should be kept in mind that this theory was applied mostly under despotic regimes. Moreover, once introduced, criminal rules are very seldom repealed. Allowing the politicians to create criminal rules without proper reflection gives them a very dangerous tool. It should be remembered that each new regulation limits the scope of the individual's freedom. How long may this process last before one would realise that the need of security deprived him of any human dignity?

The public need for the political criminalisation of activity may be strengthened in situations when the public feeling of security is menaced. As it was observed in human history, the increase in insecurity leads to limitations to the personal freedom in favour of feeling secure.[81] The beginning of the twenty-first century brought two events that agitated societies. First, the terrorist attacks of 11 September 2001 menaced the feeling of security from violence and wars. Then, the financial crisis that begun in 2008 destroyed the belief in financial development and brought the fear of unemployment, poverty, and their consequences. That opened the gate for the introduction of new criminal regulations that would restore the security and bring some form of public appeasement. Hence, the current regulation of the "dangerous domains" is based on public fears.[82] Politicians are making use of these popular sentiments to increase their power to intervene into individuals' lives.

It can be observed that, usually the political activity increases when economy slows down or even a financial crisis emerges and the main concern is to stop the unwanted tendencies and demonstrate the efficiency with the fight against the alleged reasons of the economic problems.[83] New legal rules are enacted in such a situation and the legislatures make use again of the "dubious panaceas of drastic criminal sanctions".[84] Such "toughness" has quite a big potential for one's political

[80] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 721.

[81] FROMM, Erich, *Ucieczka od wolności*, Warszawa, 1978.

[82] Ex. See: WALDRON, Jeremy, *Security and Liberty: The Image of Balance*, The Journal of Political Philosophy, 2003, Vol. 11, No. 2, pp. 191–210.

[83] As it was written by PRITCHARD, Adam C. "Politicians who happily ignored ever-climbing stock markets become profoundly interested in disclosure policy when the financial news migrates from the business page of the newspaper to the front page." in: *Self-Regulation and Securities Markets*, Regulation, Spring 2003, pp. 34–35.

[84] HOPT, Klaus J., *Modern Company and Capital market Problems: Improving European Corporate Governance After Enron*, in: ARMOUR, J., MCCAHERy, J.A. (eds.), After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US, Oxford (Hart), 2006, p. 446.

career. In the 1980s of the twentieth century in the United States of America the public learnt about the arrests of important market players accused of insider dealing. Afterwards, many of them were released and the charges against them were dropped. But this was not interesting for media. And it did not impede the rise of the political career of Rudolph Giuliani, who was then a prosecutor responsible for the arrests.[85]

The creation of the new Market Abuse Directive that replaced the Insider Dealing Directive and extended the scope of the prohibition as well as covered also the market manipulation took place about 2 years after the burst of the so-called "Dotcom bubble"[86] and a bit more than a year after the so-called "Enron scandal". It may be assumed that its enactment was motivated by the same reasons as the passage of the Sarbanes-Oxley Act in the United States of America in July 2002,[87] i.e. sending a message to the small market players that the situation on the stock exchanges is under the state's control and that they should not withdraw their savings from the market (which would start an avalanche of bankruptcies). Similarly, the origins of the Insider Dealing Directive may be traced to the mysterious market crash that took place on 19 October 1987.[88]

2 Lobby of Interested Groups

It should be noted that political actions not always result from spontaneous observation of the current events. The role of pressure groups, not always organised but efficient, should not be underestimated. More or less organised lobbies may use many social occurrences as a pretext to submit their proposition of a new legal regulation. Nonetheless, they may also agitate for the law changes by influencing public opinion. Unsurprisingly, in order to get more attention, the changes they propose usually are presented as being in the interest of everyone and not only as beneficial for a one given group.

Two important groups fighting for the new regulations may be found easily within the state's structure. First, the increasing number of criminal statutes gives more power to the police and prosecution. In consequence, it gives also more possibilities for promotion, which is usually based on the number of inquiries and

[85] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, p. 35.

[86] OFEK, Eli, RICHARDSON, Matthew P., *DotCom Mania: The Rise and Fall of Internet Stock Prices*. Journal of Finance, Vol. 58, pp. 1113–1138, June 2003.

[87] DEAKIN, Simon; KONZELMANN, Suzanne J., *Learning from Enron*, ESRC Centre for Business Research, University of Cambridge, September 2003, Working Paper No 274, The Sarbanes–Oxley Act of 2002 (Public Law 107-204, 116 United States Statutes at Large 745, enacted on 30 July 2002).

[88] CARLSON, Mark, *A Brief History of the 1987 Stock Market Crash with a Discussion of the Federal Reserve Response*, November 2006, available at http://www.federalreserve.gov/pubs/feds/2007/200713/200713abs.html (last seen on 19 October 2010).

convictions. Thus, this group always welcomes new criminal rules as a new chance for career advancement.[89]

Moreover, the creation of a new type of criminal offence, based on a complicated structure like the stock exchange, is usually followed by the creation of new specialised departments of the public offices or at least the increase in the number of their employees. All that is made in order to verify the compliance with the new rules. In case of the insider dealing criminalisation, such a development concerns not only the specialised police groups but also the competent authorities which are equipped with important investigation powers.

In relation to the insider dealing prohibition, there may be distinguished another group that warmly welcomes this regulation. As it has been already mentioned,[90] the economic analyses demonstrate that "[*t]he people who benefit most from eliminating insiders are the market professionals who must compete with them*."[91] The notion of a "market professional" in this case should include brokers, portfolio managers and all specialists that advise the other investors. Naturally, they create a lobby that insists on the introduction of regulations that disfavour insiders' activity. Moreover, by contrast with insiders who are dispersed in various companies, they create a consistent group and may use many means (educational, popularisation of the concept, legislative proposals, but also informal communication) that aim at the introduction and preservation of the insider dealing prohibition.

B Theories of Punishment

The creation and application of a criminal rule inevitably ought to lead to the question on why criminal law should be used in a given case. Some authors consider that the main objective of the criminal law is to punish, while other branches of law aim at compensation.[92] Such an opinion oversimplifies the issue. It is true that the main objective of the sanctions imposed in civil law verdicts is to compensate the suffered losses arising from a tort case or a breach of contract. But the legal system includes also administrative law that concentrates on compliance with organisational rules and imposes penalties for the behaviour that interferes with the desirable order.

However, the statement mentioned above refers to a crucial point of the analysis: punishment constitutes the basic element of the application of criminal law.

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[89] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 722.

[90] Section B.II.9, Chap. 1.

[91] TIGHE, Carla, MICHENER, Ron, *The Political Economy of Insider Trading Laws*, The American Economic Review, 1994, Vol. 84, No. 2, Papers and Proceedings of the Hundred and Sixth Annual Meeting of the American Economic Association (May 1994), p. 166.

[92] VELJANOVSKI, Cento G., *Economic of Principles of Law*, Cambridge University Press, 2007, p. 241, CHAPUT, Yves, *La pénalisation du droit des affaires: vrai constat et fausses rumeurs*, Pouvoirs, 2001/1, No. 128, p. 91.

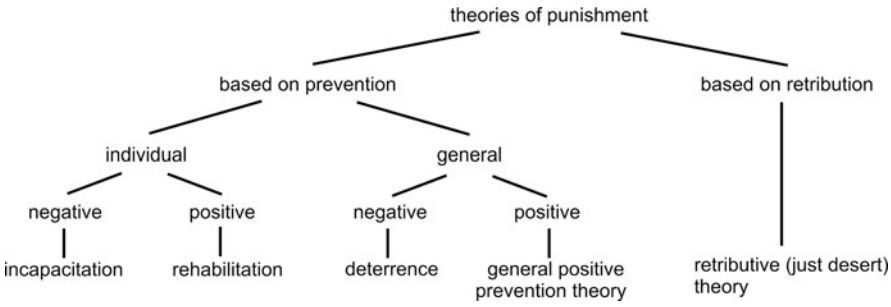

Fig. 3.1 Theories of punishment[93]

Moreover, this punishment is incomparable with sanctions applied on the basis of any other branch of law, not only because of its severity (administrative sanctions may also be burdensome) but for the reason that it is linked with the social stigma and condemnation. One may then wonder when the application of the criminal sanctions is justified. What are the objectives of the imposition of sanctions? The answer would help determine the proper scope of application of criminal law.

Over the centuries, different theories that aimed at answering these questions have been presented. According to some authors, four main bases for a theory of punishment may be distinguished: deterrence, incapacitation, rehabilitation and retribution (or desert).[94] First three of them claim that infliction of penalties is made in order to achieve some beneficial consequences (consequentialist theories). The last one concentrates on the issue of the just desert (retributive theory).[95] The main difference between these two groups may be defined as follows: only the retributive theory relates to the notion of desert and refers directly to the committed act. All other theories originate from the utilitarian theory, developed at the turn of the eighteenth century.[96] They pragmatically aim at increasing the welfare of the whole society through imposition of the punishment on an individual.

A more structured and complete presentation of the punishment theories can be found in Fig. 3.1.

This classification distinguishes primarily two groups of the punishment theories that concentrate on prevention and on retribution. This division reflects the

[93] Schema based on: ALBRECHT, Peter-Alexis, *Kriminologie: Eine Grundlegung zum Strafrecht*, 3rd edition, München : C.H. Beck, 2005, pp. 23–135.

[94] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 25.

[95] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 681.

[96] The beginning and basic principles of utilitarianism can be found in the works of Jeremy BENTHAM and John Stewart MILL. See: BENTHAM, Jeremy, *Introduction to the Principles of Morals and Legislation*, Kitchener 2000, MILL, John Stuart, *On Liberty*, Batoche Books, Kitchener, 2001.

distinction between consequentialist and retributivist theories. Then, the preventive theories may be divided into those focusing on individuals and those concentrating generally on a society. Within each of these groups, negative and positive approaches may be distinguished. The negative individual prevention theory reflects the idea of the incapacitation theory. The positive individual prevention theory includes the objectives of the rehabilitation theory. The theories referring to the whole society include the theory based on deterrence (negative general prevention) but also include the positive general prevention theory, developed in Germany, whose modern version was proposed by Günther Jakobs.

I Deterrence: Negative General Prevention Theory

The negative general prevention theory, widely known as the deterrence theory, seems to be the most developed and described theory of punishment. During the second half of the twentieth century, the theory of deterrence was "the theory" that influenced the creation of the criminal regulations.[97] This situation leads us to confront its objectives with the goals it has actually achieved.

1 Principles and Historical Development

The origins of the deterrence theory of punishment may be found in Cesare Beccaria's famous treaty "On Crime and Punishments".[98] He insisted there that it is impossible to undo the wrongs that had been done through a wrongful act and the punishment should not try to do it. In consequence, the purpose of punishment "*is nothing other than to prevent the offender from doing fresh harm to his fellows and to deter others from doing likewise*."[99]

At the same time, the utilitarian theory was developed by Jeremy Bentham. In his works, he ascertained that people are driven by two contradictory feelings: pleasure and pain.[100] The objective of the state, which acts through its government, is to promote the utility, understood as an increase of happiness or pleasure of citizens. The penalties should be conforming to this objective. As he stated: "*all*

[97] ROBINSON, Paul H., DARLEY, John M., *The Role of Deterrence in the Formulation of Criminal Law Rules : At Its Worst When Doing Its Best,* The Georgetown Law Journal, 2003, Vol. 91, p. 950.

[98] BECCARIA, Cesare, *On Crimes and Punishments and Other Writings*, Ed. Richard Bellamy, Cambridge University Press, 1995.

[99] BECCARIA, Cesare, *On Crimes and Punishments and Other Writings*, Ed. Richard Bellamy, Cambridge University Press, 1995, p. 31.

[100] BENTHAM, Jeremy, *An introduction to the Principles of Morals and Legislation*, 2000, Batoche Books, p. 14.

punishment is mischief: all punishment in itself is evil. Upon the principle of utility, if it ought at all to be admitted, it ought only to be admitted in as far as it promises to exclude some greater evil."[101] Thus, imposition of penalties should serve a more sophisticated goal than just repayment for the wrong that has been done. Its objective is to reduce the number of the people who would like to commit a similar act in the future. And it should be achieved by making them fear the pain that the criminal prosecution and punishment inflicts.

As it may be read in Cesare Beccaria's writings, two kinds of deterrence may be distinguished: individual and general. Jeremy Bentham's utilitarian theory focused rather on the general deterrence. The individual deterrence is oriented on the person of the sentenced wrongdoer. By imposing the penalties, the state tries to discourage him from violating the provisions of the law. Meanwhile, the general deterrence aims at society as a whole. The punishment inflicted on an individual should discourage other members of the community from committing a similar act just because of the fear of being punished similarly. The objective of the punishment was to create "psychological coercion" in society.[102]

According to the utilitarian two-pole view of the human motivations to act, the deterrence theory is based on an assumption that violation of a criminal law is a result of a reflection or a calculation that takes into account the possible pleasure that may be achieved through an act and the possible pain that may be inflicted for the violation of law as well as the probability of the punishment.[103] It implies that the threatening penalty should be of such an amount as to dissuade a potential wrongdoer. In consequence, its calculation does not take into account the seriousness of the wrongful act but only the social effects of the punishment. It means that the severity of penalties may exceed the damage provoked by the wrongdoer if only it would efficiently deter other members of the society.

In the 1960s of the twentieth century the belief in criminal sanctions' deterrence constituted one of the basis of the unwritten "criminal law constitution" and different approaches aimed at increasing the efficacy of deterrence. Moreover, the opinion that criminal law may sufficiently deter "white collars" was prevailing and widely accepted.[104]

The expansion of economic science and its combination with other spheres of the human activity led to the combination of the law and economics and

[101] BENTHAM, Jeremy, *An introduction to the Principles of Morals and Legislation*, 2000, Batoche Books, p. 134.

[102] Ritter von FEUERBACH, Paul Johann Anselm, *Lehrbuch des Gemeinen in Deutschland Peinlichen Rechts*, 1812, p. 177, in: ANDENAES, Johannes, *The General Preventive Effects of Punishment,* University of Pennsylvania Law Review, 1966, Vol. 114, No. 7, p 951.

[103] ASHWORTH, Andrew, *Deterrence*, in: von HIRSCH, Andrew and ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, p. 45.

[104] BALL, Harry V., FRIEDMAN, Lawrence M., *The Use of Criminal Sanctions in the Enforcement of Economic Legislation: A Sociological View*, Stanford Law Review, 1965, Vol. 17, No. 2, p. 216.

development of the theory that mixed the utility based deterrence theory with the concepts applied to effective management.[105] The economic notion of cost-benefit analysis permitted to analyse the criminal law not only from the point of view of its efficiency but also as a tool oriented towards welfare.[106] The analysis tried to find the best equation that would express the relation between benefits (gains from the violation), losses (punishment) and the element of probability of punishment. The most basic formula is:

$$IP = H/p$$

where IP is inflicted penalties, H is the amount of benefits that the offender gained or the harm he made through his act, and p is the probability of being sentenced.[107] For example, in case of a robbery of the amount of 100 and a 10% probability of being caught, the model court's verdict should be 1,000. However, in order not to oversimplify the important issue of the proper calculation of punishment, modifications to the formula should be introduced. They should take into account the existence of risk-averse and risk-immune potential criminals, additional effect of stigma expressed by imposition of a penalty, and also balance the relation between penalties for lesser and more serious crimes. If the latter problem is not solved properly one may easily decide to commit a more serious offence because of the same penalties that are threatening both acts, e.g. murder someone during an act of robbery if both robbery and murder are punished with the same severity.[108] Unfortunately, not all economists take these elements into account in their analyses.

The economic approach towards criminal law proposed a different theory of criminalisation than the principles-based one. Its objective was to find the most rational solutions from the cost-benefit point of view. Thus, a criminal was perceived as a rational actor who decides to undertake criminal activity basing on an estimation of potential benefits (i.e. the gain from the breach of a rule) and costs (i.e. the risk of being captured and convicted).[109] From the economic perspective, deterrence is the only objective of punishment.

The economic approach does not take into account any principles of proper use of criminal law. It only seeks the most effective economic solutions. For that reason, it may propose penalties that do not take into account the seriousness of the act and impose bigger penalties for trivial offences than for serious ones.

[105] The economic discussion started with BECKER, Gary S., *Crime and Punishment: An Economic Approach*, The Journal of Political Economy, March - April 1968, Vol. 76, No. 2. pp. 169–217.

[106] BROWN, Darryl K., *Cost-Benefit Analysis in Criminal Law*, 2004, California Law Review, Vol. 92, No. 2, p. 341.

[107] STIGLER, George J., *The Optimum Enforcement of Laws*, The Journal of Political Economy, 1970, Vol. 78, No. 3, p. 527, POSNER, Richard A., *An Economic Theory of the Criminal Law*, Columbia Law Review, 1985, Vol. 85, No. 6, p. 1203.

[108] POSNER, Richard A., *An Economic Theory of the Criminal Law*, Columbia Law Review, 1985, Vol. 85, No. 6, pp. 1207–1208.

[109] VELJANOVSKI, Cento G., *Economic of Principles of Law*, Cambridge University Press, 2007, p. 246.

It should be also underlined that the economic theories are based on theoretical models and not on empirical researches that would confirm their correctness.[110] Besides, a question may be asked on whether it is proper to determine the penalty on a basis of a calculation that takes into account the probability of being caught. This factor depends only on the efficiency of the police and prosecution. Thus, as the penalty increases when the risk of detection is small, it means that the wrongdoer is punished more severely only because of the state's inefficiency.

2 Concerns Arising from Application of the Theory

The positive outcome of Jeremy Bentham and Cesare Beccaria's writings and their deterrence-based theory of punishment was the development of the principle of legality. In order to deter, the laws had to be properly formulated, i.e. clearly indicate what kind of behaviour is forbidden, properly enacted, and published. Otherwise, they had no possibility to influence the society they were addressed to. It should be remembered that, at the time when both authors presented their theses, these preconditions were not respected and harsh penalties were inflicted discretionally. The idea that one may be deterred if only the rules and the threat for their violation penalties were widely known influenced the development of the modern codifications.

Nevertheless, it should be observed that, in spite of the authors' belief, the theory was not proved to be efficient and one may have concerns regarding its justness.

The basic objection to the deterrence theory is that it allows for the imposition of excessive penalties if only they may deter more individuals from committing a similar offence. The authors of this theory, Cesare Beccaria and Jeremy Bentham, were aware of this problem and proposed their own solution. They referred to the principle of proportionality and advocated the application of the smallest punishment that was sufficient to deter others from committing similar crime. But still they were focused on society and future gains that may be achieved through application of criminal rules.[111] Thus, their calculations did not take into account the balance between one's desert and penalties. One may easily imagine a situation, e.g. an often-committed offence of theft of a low-value object, where (taking into account the low level of detection) applied sanctions should be quite elevated in order to deter other potential offenders. Moreover, the strict deterrence-based

[110] ASHWORTH, Andrew, *Deterrence*, in: von HIRSCH, Andrew and ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, p. 46.

[111] BECCARIA, Cesare, *On Crimes and Punishments and Other Writings*, Ed. Richard Bellamy, Cambridge University Press, 1995, p. 31, BENTHAM, Jeremy, *An introduction to the Principles of Morals and Legislation*, Batoche Books, 2000, Chapter XIV.

utilitarian approach may even accept punishment of an innocent if only it could have beneficial effects for the welfare of the whole society.[112]

Additionally, no all supporters of this theory agree to limit the penalties according to the principle of proportionality. Besides, the proposed limitation, like the in case of cost-benefits analysis may still lead to very strict rules of liability. The defenders of the deterrence theory consider that even the severest sanctions are just if they are analysed from the *ex ante* point of view. In theory, everyone knows what kind of penalty is applicable to a given breach before he breaches a criminal rule.[113] Nonetheless, such an approach does not seem to be convincing. No one should face the risk of 10 years in prison for stealing a loaf of bread even if they were aware of such a threatening penalty in advance and if it was the best deterrent for such kind of acts. It leads to another feature of the deterrence theory, which is a popular belief that increase of penalties would reduce a rate of committed offences. Researches do not confirm this thesis.[114] Consequently, this fallacy should not be used as an argument in favour of criminalisation and application of severe sanctions.

Moreover, the theory of deterrence presupposes that a potential wrongdoer analyses the potential costs and benefits of the planned act. Usually, it does not distinguish between risk-preferring and risk-aware individuals. Meanwhile these personal characteristics may have a big influence on a final decision about violating or not the criminal prohibition. Research shows that such *pre ante* analysis is usually made on the fragmentary data available to a potential offender.[115] Thus, the main theory's assumption – that people are deterred from committing crime by the threat of punishment – may be questioned.[116] The discussion also concerns the

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[112] ASHWORTH, Andrew, *Deterrence*, in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, p. 47.

[113] VELJANOVSKI, Cento G., *Economic of Principles of Law*, Cambridge University Press, 2007, p. 255.

[114] See e.g.: von HIRSCH, Andrew, BOTTOMS, Anthony E., BURNEY Elisabeth, WIKSTRÖM, Per-Olof, Criminal *Deterrence and Sentencing Severity*, Hart Publishing, 1999.

[115] BAER, Miriam H., *Linkage and the Deterrence of Corporate Fraud*, 2008, Virginia Law Review, Vol. 94, 2008; Brooklyn Law School, Legal Studies Paper No. 123. Available at SSRN: http://ssrn.com/abstract=1290710, p. 1306.

[116] *"The social science literature suggests that potential offenders commonly do not know the law, do not perceive an expected cost for a violation that outweighs the expected gain, and do not make rational self-interest choices."* in: ROBINSON, Paul H., DARLEY, John M., *The Role of Deterrence in the Formulation of Criminal Law Rules : At Its Worst When Doing Its Best*, The Georgetown Law Journal, 2003, Vol. 91, p. 953; other examples: "*one study of English burglars found that they rarely thought they would be caught for the present offence, that they were not worried about the consequences of being caught [. . .], and that the rewards of the burglary were rarely known in advance."* ASHWORTH, Andrew, *Deterrence*, in: von HIRSCH, Andrew and ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, pp. 49–50 based on BENNETT, T., WRIGHT, R., Burglars on Burglary, 1984, chapters 5 and 6; *"The results suggest that 76 percent of active criminals and 89 percent of the most violent criminals either perceive no risk of apprehension or have no thought about the likely punishment for their crimes"* in: ANDERSON, David A., *The Deterrence Hypothesis and Picking Pockets at the Pickpocket's Hanging*, American Law and Economics Review, 2002, Vol. 4, No. 2, p. 295.

notion of "marginal deterrence", i.e. the increase or decrease of the deterrence level provoked by varying the severity of sanctions.[117] Practice shows that, although the existence of the punishment system does have a deterring effect, the effort to manipulate the rate of the committed offences by criminal regulations has not succeeded, among other reasons because it is practically impossible to predict how the regulation would work in the real world.[118]

Besides, research demonstrates that the most deterring element of the criminal prosecution is not the severity of the sanction but its probability.[119] Of course it should be noticed that existence of draconian penalties does deter many from committing crime. Many dictatorships existed on this basis.[120] However, it is doubtful whether such reference should be used to improve the performance of a democratic society. For this reason the theory of deterrence may be also undermined by the lack of proper detection of the wrongdoers. Often, in order to limit the results of the low probability of detection, the legislature decides to increase the severity of the penalties threatening for the commission of a wrongful act.[121] As it was mentioned above, it is not the best solution and may lead to demotion of the criminal law in the citizens' perception.

It should be also underlined that the creation of a normative prohibition does not mean that society begins to perceive a given conduct as blameworthy.[122] It had been observed in Poland, under the communist regime, that criminalisation of the offences that were aiming at conservation of the so-called "socialist property" were not considered justified by individuals and that they were not respected.[123]

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[117] ASHWORTH, Andrew, *Deterrence*, in: von HIRSCH, Andrew and ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, p. 48.

[118] ROBINSON, Paul H., DARLEY, John M., *The Role of Deterrence in the Formulation of Criminal Law Rules : At Its Worst When Doing Its Best*, The Georgetown Law Journal, 2003, Vol. 91, pp. 951–952.

[119] ANDENÆS, Johannes, *The General Preventive Effects of Punishment,* University of Pennsylvania Law Review, 1966, Vol. 114, No. 7, pp. 960–970, BAER, Miriam H., *Linkage and the Deterrence of Corporate Fraud*, 2008, Virginia Law Review, Vol. 94, 2008; Brooklyn Law School, Legal Studies Paper No. 123. Available at SSRN: http://ssrn.com/abstract=1290710, p. 1306, ROBINSON, Paul H., DARLEY, John M., *The Role of Deterrence in the Formulation of Criminal Law Rules : At Its Worst When Doing Its Best*, The Georgetown Law Journal, 2003, Vol. 91, p. 977.

[120] ANDENÆS, Johannes, *The General Preventive Effects of Punishment,* University of Pennsylvania Law Review, 1966, Vol. 114, No. 7, p. 970.

[121] ANDENÆS, Johannes, *The Morality of Deterrence*, The University of Chicago Law Review, 1970, Vol. 37, No. 4, p. 654.

[122] Similarly: ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 120–123.

[123] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 121, GARDOCKI, Lech, *Zagadnienia teorii kryminalizacji*, Warszawa, 1990, p. 55 ff.

In result, it may be stated that the deterrence theory, although it played an important role in the historical development of criminal law, seems to be inadequate to deal with the issue of justice which should be one of the cornerstones of the criminal law theory. It concentrates on notions like efficacy and, if applied consequently could lead to the imposition of harsh penalties for all possible offences. Finally, what could be more efficient that the vision of serving long time in prison? But the society one lives in is not composed of human-automats that make profound estimations before conducting any action. Unfortunately, only in such an inhuman environment the theory would be most well-grounded and effective.

When applied to "normal people", the deterrence theory, especially in the economic version was well characterised and criticized by the English Court of Appeal, which, referring to the deterrence idea stated that it should not "result in a convicted man being made the scapegoat of other people who have committed similar crimes but have not been caught and convicted".[124]

II Rehabilitation: Positive Individual Prevention

The most ambitious theory of punishment aims at reforming the offender through punishment. It wants to develop such a positive motivation that it would lead to respect for the legal order and prevent further offences.[125] The theory's objective is in fact very similar to that of the theory based on deterrence. Both want to prevent the future violations of the law. However, the deterrence theory is based on the fear of punishment. Meanwhile, the rehabilitation treats an offender like an "ill" person and, in consequence, wants to "cure" him or her of his/her criminal tendencies.[126] In practice, its objective is then to change the offender's attitude towards crimes. Although this theory at first glance seems to be concentrated on the offender's person, in fact it focuses on the protection of other members of the community: a successful rehabilitation protects them against being victimised. The efficacy of the rehabilitation theory could be measured by the rate of recidivism.[127]

The theory was elaborated by Franz von Liszt, author of the sociological school of the criminal law at the turn of the twentieth century. The main assumption of this approach was that penalty should be more concentrated on the person of the offender and his social environment than on the wrongful act itself. In consequence,

[124] *Withers*, 1935, 25 Cr App. Rep. 54 in: VELJANOVSKI, Cento G., *Economic of Principles of Law*, Cambridge University Press, 2007, p. 255.

[125] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 53.

[126] von HIRSCH, Andrew, *Rehabilitation*, in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, p. 1.

[127] von HIRSCH, Andrew, *Rehabilitation*, in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, p. 1.

the penalties should vary depending on the offender's character, on whether he had committed already any offences, and on the risk of recidivism. In case of an "irreparable" wrongdoer the penalty should simply not allow him to commit similar offences in the future. If, in the court's opinion, there are chances of "improvement", the penalty should take this factor into account and help the sentenced person to re-join the rest of the society.[128]

This idealistic approach developed and faded during the twentieth century.[129] Its critics presented various arguments. The idea of reform implies state's intervention into one's freedom; it bases on an assumption that one may be "reprogrammed" to suit the others. Moreover, as different persons require different methods of rehabilitation, the proportionality between an act and the punishment would be impaired. It seems that the notion of desert is incompatible with the notion of rehabilitation.[130] Finally, the effectiveness of the rehabilitative programmes was also questioned. Nevertheless, the signs of its revival could be noticed in the 1990s of the twentieth century[131] when new methods concentrating on offender's reasoning skills were applied.[132] But still, the empirical researches do not confirm the optimism of the supporters of this theory.[133] It should be noted that this philosophy of punishment applies to "traditional" offences and white-collar crimes seem to be beyond its interest.

III Incapacitation: Negative Individual Prevention

The objective of the punishment based on the incapacitation theory is to render the offender incapable of committing crimes.[134] It may be made through death penalty

[128] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 698, SÓJKA-ZIELIŃSKA, Katarzyna, *Historia prawa*, Warszawa, 1997, pp. 337–338.

[129] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 54, Von HIRSCH, Andrew, *Rehabilitation*, in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, p. 2.

[130] Similar concerns: REX, Sue, *A New Form of Rehabilitation?,* in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, pp. 38–39.

[131] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, pp 54–61 and the literature there cited.

[132] von HIRSCH, Andrew, *Rehabilitation*, in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, pp. 4–5.

[133] REX, Sue, *A New Form of Rehabilitation?,* in: von HIRSCH, Andrew, ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, pp. 34–41.

[134] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 46.

(one will never commit a crime again), but in modern societies it is usually made through imprisonment or other means that impede certain behaviours: e.g. the withdrawal of a driving licence reduced the risk of future offences linked to the driving of a car. The penalties of the same kind may also be used in application of the other punishment theories. However, when they are used in order to incapacitate an offender, they are likely to be longer or more severe than for the purposes of the other theories. In that way, they would try to achieve their basic objective of impeding the commission of a new offence.

The notion of incapacitation is applied usually in relation to the most serious crimes and dangerous offenders who commit crimes as long as they are able to do so.[135] The problem with the punishment based on the theory of incapacitation is that in some way it punishes an act that has not yet been committed. And it is not sure whether it would be in fact committed.[136] The researches demonstrate that applied methods of future behaviours prediction tend to "overpredict" the forecast of criminality.[137] Moreover, the harshness of the penalties does not comply with the principle of proportionality. The penalty, whose objective is to prevent the future law violations, does not take into account the balance between the wrongful act and punishment for it. These concerns discourage applying this theory of punishment, at least as a main foundation of the criminal policy.

IV Restitution of a Norm: Positive General Prevention

The positive general prevention theory may be seen as a supplement for other theories concentrating on deterrence. The latter focuses on the person of the potential offender who should be discouraged from breaching the criminal rule. Meanwhile, the positive prevention theory insists on the creation of such a social model of behaviour that does not take into account the commission of an offence.[138] This theory is also sometimes called "educative deterrence".[139] It was distinguished and developed in the German legal science.[140] However, some authors consider that

[135] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, pp. 46–47.

[136] Similarly: CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 49.

[137] von HIRSCH, Andrew, *The problem of False Positives*, in: von HIRSCH, Andrew and ASHWORTH, Andrew (eds.), Principled Sentencing Readings on Theory and Policy, Oxford: Hart Publishing, 1998, pp. 98–101.

[138] JAKOBS, Günther, *Imputation in Criminal Law and the Conditions for Norm Validity*, 2004, Buffalo Criminal Law Review, Vol. 7, p. 492.

[139] CLARKSON, C.M.V., *Keating*, H.M., Criminal Law: Text and Materials, London Sweet & Maxwell, 2003, pp. 35–45.

[140] DUBBER, Markus Dirk, *The Promise of German Criminal Law: A Science of Crime and Punishment*, German Law Journal, 2005, Vol. 6, No. 7, p. 1070.

the general positive prevention theory makes part of the general deterrence and there should be no further distinguishing between them.[141]

The theory has a huge potential as a justification of criminal law. Other theories based on deterrence have difficulties to prove their efficacy. The increasing number of convictions demonstrates that there are many individuals who are not deterred by the existence of criminal provisions. The positive prevention theory cannot be verified by any empirical evidence, which makes it non-falsifiable.[142] There are always individuals who obey the law and do not take into consideration the solutions that would violate criminal provisions. According to the general prevention theory, the existence of criminal law should reinforce such an attitude.

Günther Jakobs elaborated the modern version of the theory. In his works, he introduced into the legal domain the sociological theories of Niklas Luhmann. This theory, based on structural functionalism, claims that the existence of a society depends on the existence of valid norms.[143] The notion of "norm" should be understood as an expectation that one will behave in a certain way in a certain situation.[144] Hence, the norms play a very important role because they bring security and predictability to human behaviour. A violation of a norm should be understood as its negation, which undermines also the whole social system. The imposition of a sanction is necessary in order to formally confirm that the norm is still valid. And through the confirmation of the norm, the identity of the society as a social system is confirmed and assured.[145] In consequence, the criminal law is used as a technical instrument that focuses on auto-conservation and defence of the society.

It should be underlined that this theory refers only to the technical aspects of the application of law. It does not give any indications concerning the content of the law. It concentrates only on the functions that the law has in society. According to Günther Jakobs, the issue of the content of the law belongs to the sphere of the politics and not to the sphere of law.[146] Thus, both the content of the norm and the punishments threatening for the norm's violations depend on the decision of the legislature. The observation of the current criminalisation trends confirms that the

[141] ANDENÆS, Johannes, *The General Preventive Effects of Punishment*, University of Pennsylvania Law Review, 1966, Vol. 114, No. 7, p. 950.

[142] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 702.

[143] BALLESTEROS, Alberto Montoro, *El funcionalismo en el Derecho: Notas sobre N.Luhmann y G. Jakobs, Annuario de derechos Humanos*, Nueva Época, 2007, Vol. 8, p. 372.

[144] JAKOBS, Günther, *Imputation in Criminal Law and the Conditions for Norm Validity*, Buffalo Criminal Law Review, 2004, Vol. 7, p. 492.

[145] BALLESTEROS, Alberto Montoro, *El funcionalismo en el Derecho: Notas sobre N.Luhmann y G. Jakobs, Annuario de derechos Humanos*, Nueva Época, 2007, Vol. 8, p. 373.

[146] JAKOBS, Günther, *Sociedad, norma y persona en la Teoría de un Derecho penal funcional*, 1st ed., Ed. Civitas, Madrid, 1996, pp. 40–41, presented in : BALLESTEROS, Alberto Montoro, *El funcionalismo en el Derecho: Notas sobre N.Luhmann y G. Jakobs, Annuario de derechos Humanos*, Nueva Época, 2007, Vol. 8, p. 374.

politicians are eagerly making use of their power to create the content of the law. However, one may wonder whether this process is based on a reflection on the positive general prevention theory or rather whether it arises from the fact that the theory and principles of law have been forgotten.

V Retribution

The theory of retribution is the only theory that takes into account the notion of justice. Other theories that justify imposition of a criminal punishment and propose methods of evaluation of its proper amount concentrate on other goals. As it was mentioned above, through the punishment they want to influence other than the author of the act members of the community. It should be noted that one can speak about "just punishment", but it is impossible to speak about "just deterrence" or "just rehabilitation."[147]

The notion of justice was analysed by the philosophers since the beginning of human civilisation. Christianity brought to the world the notion of equality of all human beings.[148] On this basis, conclusions regarding the violation of others' rights were obtained. For instance, Saint Thomas Aquinas saw criminal penalty as a mean to restore the balance violated by the offence (*per peonam reperatur aequalitas*).[149] A more developed theory of retributivism originates from the writings of Immanuel Kant and Georg Wilhelm Friedrich Hegel, who developed the notion of criminal offence as an advantage taken on the expense of other persons' rights.[150] This theory refers to the hypothetical notion of social contract that was entered into by the members of the society. By this contract they agreed to limit part of their freedom and entrust some functions to the state's authority. This contract assumed that all individuals are and should be treated equally. If they limit their freedom (by legal acts regulating different domains), this limitation applies to all members of the community to the same extent.[151] Moreover, if one violates someone else's most important rights, the prosecution and punishment may be imposed only by the state. Individuals have waived the right to punish their offenders on their own.[152] This

[147] LEWIS, Clive Staples, *The Humanitarian Theory of Punishment,* VI Res Judicatae, 1953, reprinted in: CLARKSON, C.M.V., KEATING, H.M., Criminal Law: Text and Materials, London Sweet & Maxwell, 2003, pp. 30–32.

[148] Letter of St Paul to the Colossians, 3:11.

[149] SÓJKA-ZIELIŃSKA, Katarzyna, *Historia prawa*, Warszawa, 1997, pp. 179–180.

[150] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, pp. 700–701.

[151] MURPHY, Jeffrie G., *Kant: The Philosophy of Right*, New York, St. Marin's Press, 1970, p. 142, presented in: SCHEID, Don E., Kant's Retributivism, Ethics, 1983, Vol. 93, No. 2, pp. 264–265.

[152] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, pp. 22–26.

fundaments lead to the conclusion that the violation of a legal rule by an offender gives him an advantage over the other members of the society who obey the rules and restrict their behaviour in order not to violate the freedom of others.[153] In consequence, by the breach of a rule not only did he victimise an individual but he also destroyed the equilibrium of the community: *de facto* he claimed to possess the special rights that he did not actually have. The main objective of punishment is to restore the initial order by depriving the wrongdoer of his unjust advantage over others. This advantage should not be understood as, e.g. a pecuniary gain resulting from his behaviour. The gain is already achieved by misuse of his freedom and violation of a legal rule. One who violates the rules enjoys the same benefits of the system as its others members. But he does not agree to share the common burden of self-restrain. Taking this advantage is unfair. Thus, the punishment aims at its removing.[154] Because the punishment is imposed on a person intentionally taking advantage of others, the punishment has to measure the advantage and "compensate" it. Moreover, the wrongdoer should be treated according to the famous Kantian phrase as a goal and not merely as a means.[155] It means that the prosecution and punishment should be exercised with maximal care for justice. Punishment cannot be oriented on any other goal than restoration of the position the wrongdoer initially had in the society.

It should be underlined that the theory of retributivism does not determine what kind of penalty is proper in a given case.[156] The concept of retribution should not be understood as a direct application of *lex talionis*.[157] It is not aiming at inflicting on the wrongdoer exactly the same kind of harm as his behaviour had provoked. It is the role of the enacted laws to determine the scope of the punishment that may be applied and then the role of the judges to define its precise amount. In both latter cases, the principles of the proper formulation of the criminal law should be applied.[158]

The critics of this kind of justification underline that it cannot be claimed that punishment annuls or erases the crime. Punishment always takes places after the wrongful act and it cannot cause the past event not to have happened. If one cannot change the past happenings, he should not try to impose the penalties that aim at

[153] BRADLEY, Gerard V., *Retribution: The Central Aim of Punishment*, Harvard Journal of Law and Public Policy, 2003, Vol. 27, No. 1, p. 23.

[154] MORRIS, Herbert, *Persons and Punishment*, Monist, 1968, Vol. 52, No. 4, pp. 475–501. The author, interestingly, develops the retributive theory of punishment based on the same premises as Immanuel Kant, without making any reference to the latter philosopher.

[155] HEIDER, Fritz, *The Psychology of Interpersonal Relations*, New York: Wiley 1958, pp. 263–276.

[156] BRADLEY, Gerard V., *Retribution: The Central Aim of Punishment*, Harvard Journal of Law and Public Policy, 2003, Vol. 27, No. 1, pp. 21–22.

[157] BRADLEY, Gerard V., *Retribution: The Central Aim of Punishment*, Harvard Journal of Law and Public Policy, 2003, Vol. 27, No. 1, p. 20.

[158] They are presented in subsequent Sect. C.II dedicated to principles of criminalisation.

their "disappearance". It should be thus underlined that, according to retributive theory, punishment is not aiming at erasure of the offence from the history, but at restoration of the offender to the society. This element is sometimes even misunderstood by the authors that support the retribution. They propose, meanwhile, a biology-derived explanation and insist on the fact that punishment is a natural reaction to the wrong, or something that man is born with and that has enabled him to survive during the ages and encouraged cooperation with others.[159] Man was punishing the wrongdoers during its history and, thanks to that, the positive elements of social order could have been developed. But such an explanation cannot, however, be accepted; at least not as a justification for a legal theory of punishment. As it was rightly observed, it deprives the retribution theory of any cognitive element and reduces punishment to an instinctive reflex.[160] Such a justification in fact helps the critics of retribution because it removes the distinction between the primitive punishment inflicted in a state of rage and punishment based on just desert premises. Retribution does not mean application of a penalty in a state of rage, provoked by anger or will of revenge.[161] The punishment is imposed rationally after having taken into account all circumstances of the wrongful behaviour. Moreover, it oversimplifies the objectives of the punishment. Its goal is not to make the wrongful act vanish or pretend that it has never existed. It aims at the nullification of the evidence that wrongdoer considered himself to be above his victim and not obliged to respect the rules that bind society. And restoring the place the wrongdoer should have in the society – as an equal among the other equals. It ought to be also observed that by punishing the wrongdoer, the society compensates the degradation of the victim that was deprived of his natural freedom by the violation caused by someone else.[162]

It should be underlined that the objective of the penalty based on the retribution theory is to restore social balance and not to make the wrongdoer suffer.[163] This notion is not always well understood by the researchers. Many of them consider the Kantian theory as being too harsh. For them the images of Kant as a humanist

[159] MACKIE, John L., *Morality and Retributive Emotions*, Criminal Justice Ethics, 1982, No. 1, Vol. 1, p. 5.

[160] HAMPTON, Jean, *A New Theory of Retribution*, in: FREY, G.M. and MORRIS, Christopher W. (eds.), Liability and Responsibility: Essays in law and Morals, New York: Cambridge University Press, 1991.

[161] BRADLEY, Gerard V., *Retribution: The Central Aim of Punishment*, Harvard Journal of Law and Public Policy, 2003, Vol. 27, No. 1, p. 21.

[162] Similarly: HAMPTON, Jean, *A New Theory of Retribution*, in: FREY, G.M. and MORRIS, Christopher W. (eds.), Liability and Responsibility: Essays in law and Morals, New York: Cambridge University Press, 1991.

[163] BRADLEY, Gerard V., *Retribution: The Central Aim of Punishment*, Harvard Journal of Law and Public Policy, 2003, Vol. 27, No. 1, p. 30.

philosopher and as a supporter of strict punishment are incompatible.[164] In the author's opinion, such an approach stems from not understanding all the elements of Kant's legal theory.

In conclusion, it must be observed that the desert-based theory of punishment is in fact more in favour of the accused person than any of the society-welfare oriented theories. The desert-based theory established limits for the state's intervention and create limits that cannot be overstepped. Moreover, it reduces the disparities between the penalties when two similar breaches are sentenced.[165] The penalty that may be imposed according to its principles must reflect the individual guilt of the wrongdoer. In order to be just, the penalty has to be proportionate and does not exceed the "amount of the wrong" that has been done to the victim. Meanwhile, according to the consequentialist theories, one may suffer a penalty severer than necessary to reflect the wrongfulness of the act if only it would potentially have a good influence on the whole society. An eventual disadvantage for a wrongdoer who is punished on the basis of just-desert theory is that the penalty would not be reduced either, even if punishment would presumably have no influence on the society. But at this moment, the reference to human dignity and the objective to treat one as a goal and not merely as a means should be made. After all, smaller-than-just punishment means that the offender is not treated seriously as a human being but only as a tool of social engineering.

VI Conclusion

The presentation of the five basic theories of punishment proves that imposition of a penalty in a criminal proceeding may be based on many different foundations. As they differ in the most basic characteristics, choosing one of them may have an important impact on the rendered verdict and the life of the sentenced person. It should be observed that these theories are partly overlapping each other. For instance, every imprisonment is in fact barring the wrongdoer from committing a similar (or any other) crime during the given period of time. But being sentenced for such a penalty does not automatically mean that incapacitation was the judge's main objective.

Choosing any consequentialist theory means that the law is used as a tool of social technique. It tries to influence the individual or governed society by creation of severe penalties that threaten the violation of the rules or promotion of the abidance by legal rules. Only the reference to the retributivist theory assures that

[164] E.g. SMITH, Nick, *Kantian Restorative Justice?,* Criminal Justice Ethics, 2010, Vol. 29, No. 1, p. 54, RADZIK, Linda, *Making Amends: Atonement in Morality*, Law, and Politics, New York: Cambridge University Press, 2009.

[165] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 33.

the issue of "*ius*" or justice is analysed and the person of wrongdoer as a human being is treated seriously; not as a means for creation of a social attitude towards certain behaviour but as an individual who merits just treatment. Even if this treatment means his punishment, it is imposed with proper consideration and without violation of the rights of the wrongdoer.

C Criminalisation

The previous section of this chapter aimed to indicate the reasons why criminal law is used and what are its objectives. The choice of one of the theories of punishment creates the foundations for the criminal policy and the way the penalties are imposed. Now, it shall be analysed what are the conditions of a proper creation of criminal regulations. The cornerstone of the criminal law is proper criminalisation, i.e. a decision of the legislature that a given human behaviour should be forbidden and its commission punished.[166] Criminalisation is an act of an entitled public entity to define a human behaviour that constitutes a public wrong and to prohibit it.[167] The violation of the prohibition is prosecuted by the state's officials and punished according to the criminal law that provides the amount of the applicable penalty. In doctrine, the opinion can be found that criminalisation should be seen as "*the overall framework for study of criminal law and of the criminal justice and penal process*".[168] Everything that happens after a criminal rule is enacted is only an outcome of the process of creation of the rule. And if this process is not conducted properly, unexpected concerns may arise. It must be observed that criminalisation is not only important but, unfortunately, is also not simple. The notion implies the existence of a process aiming at creation of a new criminal rule. And how this process is conducted influences afterwards the whole functioning of the criminal law.

The decision to criminalise a given behaviour should be taken carefully, according to the principled schema. It does not mean that there can be elaborated a mathematical formula that matches all cases and gives an unambiguous answer on when the use of criminal law is proper and desired and what the proper formulation of the rule is. Nevertheless, it does not mean that acting on the basis of principles is

[166] ZAWŁOCKI, Robert, *Kryminalizacja obrotu gospodarczego w Polsce*, in: DUKIET – NAGÓRSKA, Teresa (ed.), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, p. 214.

[167] Similarly: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 6.

[168] LACEY, Nicola, *Historicising Criminalisation: Conceptual and Empirical Issues*, The Modern Law Review, 2009, Vol. 72, No. 6, p. 942.

useless. The principles-based approach helps determine the need of application of criminal law and the proper formulation of the rules. Otherwise, the application of criminal law risks being made arbitrary as a result of a political action or media pressure.

The principles-based procedure aiming at criminalisation is composed of two main parts. First, a decision must be taken on whether a given human conduct is wrongful and whether it should be regulated with the help of legal tools. The positive answer for this question does not lead to automatic application of criminal law. The legal order offers also other means of control of human conduct, such as civil or administrative law. Besides other, extralegal, ways of regulation should not be disregarded. It cannot be forgotten that the decision regarding wrongfulness of an act may be taken on the basis of different theories. The criminal law doctrine influences the approach chosen in order to criminalise an act.[169] In consequence, it may lead to different results in judgment and discrepancies in opinion on what behaviour is wrongful enough that it requires the launching of a legislative procedure.

The next step consists in the application of principles of criminalisation. Their action is twofold. First, they help decide whether criminal law is "the" kind of regulation that should be applied. If their application leads to a conclusion that a criminal law rule should be added to the legal order, their second objective is to determine minimal standards for the proper formulation of the rule. A properly created criminal rule should clearly describe all the elements of the prohibited act as well as place it within the frame of criminal law, i.e. indicate the basis of the responsibility and possible exculpations or exonerations.[170] Application of both steps may be compared to the filtres that allow for the distillation of a proper criminal rule.

The following sections of this chapter present this two-part procedure of criminalisation: the possible bases for deciding whether a given behaviour deserves to be regulated and the principles that authorise application of criminal law. Moreover, they tackle the issue of the extralegal reasons of criminalisation and they attempt to demonstrate their inappropriateness.

[169] Similarly in: HUSAK, Douglas, *Overcriminalization: The Limits of the Criminal Law*, Oxford University Press, 2008. However, another approach is also possible that justification for criminalisation comes from an independent principle of justice which is outside the criminal law doctrine, see: GREEN, Stuart P., *Is There Too Much Criminal Law?,* Ohio State Journal of Criminal Law, 2009, Vol. 6, p. 739.

[170] Some authors distinguish the creation of the rule and the establishment of its place within criminal law as independent steps, e.g. ZAWŁOCKI, Robert, *Kryminalizacja obrotu gospodarczego w Polsce*, in: DUKIET – NAGÓRSKA, Teresa (edited by), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, pp. 214–215.

I Distinguishing the Need to Undertake a Legislative Action

The first step that should be undertaken in order to deal with an unwelcomed behaviour is to analyse whether the conditions for initialising a legislative action are met. It should be underlined that a positive answer to this question does not mean that the application of criminal law is necessary. It only enables further examination that, potentially, may lead to its eventual application.

The first-step tools of this theoretical analysis are aiming at declaration that a given act merits condemnation, i.e. is wrongful.[171] This examination can provoke already first concerns because, in order to reach a conclusion about the wrongfulness of a behaviour, many different theories may be applied. As a result, each of them may lead to a different ending and insist on a regulation of the behaviour that is not blameworthy according to another theory.

The following subsections present shortly the main principles of six different theories that help decide about wrongfulness of an act, namely legal positivism, moralism, paternalism, legal liberalism (also known as the harm principle), a *Rechtsgut* theory and a liberal theory based on protection of human rights.

1 Legal Positivism

Legal positivism is not usually mentioned as a theory that helps to determine whether given behaviour is wrongful and, consequently, should be regulated by law.[172] This omission, however, seems to be unjustified because this theory gives its own answer to the question.

In its "purest" version, legal positivism is based on three assumptions: (1) binding legal acts (i.e. positive law) are the result of the human activity, (2) the state's authority imposes their respect and obedience and (3) they are distinct from any extra-legal moral rules.[173] These three conditions provide an answer to the question on when the legislature is entitled to introduce a new rule into the legal system. Namely, it may do that whenever it wants to. The issue of wrongfulness is irrelevant because the will of the legislature is a sufficient criterion for the creation

[171] About the need to declare an act wrongful in order to criminalise it see: CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 4, ASHWORTH, Andrew, *Is the Criminal Law a Lost Cause*, 2000, Law Quarterly Review, Vo. 116, p. 240.

[172] For example see the list of the theories in: CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 4.

[173] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, *Historia doktryn politycznych i prawnych*, 2nd edition, 1994, p. 398.

of a new regulation. Moreover, individuals do not have any other rights that are attributed to them by the binding acts.[174]

For the formal positivists, the most important was the fact that the law was introduced properly to the legal system, i.e. respecting all the rules governing the legislature's activity and procedure of enactment.[175]

As for the content of the law, Jeremy Bentham and John Austin, the "fathers" of legal positivism, had already underlined in their works that there should be made a distinction between what law is and what it ought to be, and that one should concentrate on the first issue.[176] In consequence, violation of any standards of morality does not deprive the rule of the character of law.[177] As a German positivist, Karl Magnus Bergbohm, stated "*the most despicable act of parliament, if only it had been properly enacted, is binding and effective*".[178]

Such an approach allows to establish easily which legal rules are binding: those that have been enacted and are enforced by the state. According to positivists, it allowed individuals to know what the law is and, in consequence, to respect it.[179]

It cannot be denied that this "scientific" (according to the positivists[180]) approach is to some extent required and even beneficial for the legal system as a whole. It creates the rules describing the procedure, indicates the entity that is authorised to enact the acts that are considered to create legal obligations and should be respected as legal rules. At its origins positive approach and principle of legality were interconnected and till today, to some extent the positivist approach protects individuals from the judges' discretion.[181]

But one may wonder whether such an approach is sufficient in order to create a properly functioning legal system. Already the first authors who insisted on the separation between law and morals did not claim that law should not respect any external rules.[182] They only underlined that law did not derived its binding power

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[174] DWORKIN, Ronald, *Taking Rights Seriously*, Harvard University Press, Cambridge, Massachusetts, 1977, p. xi.

[175] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, *Historia doktryn politycznych i prawnych*, 2nd edition, p. 399.

[176] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, Historia doktryn politycznych i prawnych, 2nd edition p. 397.

[177] HART, H.L.A., *Positivism and the Separation of Law and Morals*, Harvard Law Review, 1958, Vol. 71, No. 4, p. 599.

[178] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, *Historia doktryn politycznych i prawnych*, 2nd edition, p. 399.

[179] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, *Historia doktryn politycznych i prawnych*, 2nd edition p. 399.

[180] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, *Historia doktryn politycznych i prawnych*, 2nd edition, p. 397.

[181] DYZENHAUS, David, *The Rule of Law as the Rule of Liberal Principle*, in: RIPSTEIN, Arthur (ed.), Ronald Dworkin, Cambridge University Press, 2007, p. 58.

[182] The examples and citation can be found in: HART, H.L.A., *Positivism and the Separation of Law and Morals,* Harvard Law Review, 1958, Vol. 71, No. 4, pp. 593–629.

from any external sources other than the will of the legislature. In the nineteenth and the first half of the twentieth centuries the positivistic theory was developing without making reference to any external rules. It was the Nazi and communistic experiences that demonstrated the need of a reference to some external principles that would help determine the proper shape of the legal intervention into particulars lives. Thus, even the legal philosophers that wanted to restore the purely scientific analysis of the law like Hans Kelsen, referred to the notion of a basic rule of law (*Grundnorm*) that cannot be found in binding legal acts.[183] Another solution was defended by H.L.A. Hart, who introduced the notion of the rules of recognition, i.e. the rules that regulate the proper way in which a new law may be created in order to be considered as a law.[184] However, such propositions undermine the essence of the positivism because positivists do not accept the existence of any unwritten rules that would influence application of written laws.

Legal positivism created a very useful basis for analysis of the existing laws. It is used to determine whether given legal rules are binding, were properly enacted or repealed, etc. But the answer that its pure form proposes for creation of new laws, i.e. consent for unlimited legislature's activity, is unacceptable. The historical experiences showed that additional criteria must be used. Otherwise, violation of the individual's basic rights and freedoms may occur.

2 Moralism

Going from the theory of legal positivism to legal moralism is like swinging a pendulum. These two theories are based on completely different premises.

The theory of legal moralism ascertains that law should be used in order to enforce the moral convictions of the community.[185] The most famous (and probably the most criticised) advocate of this theory, Lord Patrick Devlin, stated that "*it is not possible to set theoretical limits to the power of the state to legislate against immorality. It is not possible to settle in advance exceptions to the general rule or to define inflexibly areas of morality into which the law is in no circumstances to be allowed to enter.*"[186]

One of the controversial issues in criminalisation is the question of whether the fact that a given behaviour is considered to be morally wrongful gives sufficient

[183] OLSZEWSKI, Henryk, ZMIERCZAK, Maria, *Historia doktryn politycznych i prawnych*, 2nd edition, pp. 402–405.

[184] DWORKIN, Ronald, *Taking Rights Seriously*, Harvard University Press, Cambridge, Massachusetts, 1977, pp. 19–45.

[185] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 4.

[186] DEVLIN, Patrick, *The Enforcement of Morals*, Oxford University Press, 1965, pp. 12–13.

justification for its criminalisation.[187] The issue still provokes many controversies in the domain of sexual morality, but its application should be also analysed from the point of view of the market practices. Depending on the approach that one has, a given market behaviour may be an intelligent way of investment or an immoral exploitation of the advantage that one possesses over the other market participants.

Meanwhile, if the existence of the extra-legal moral rules that should be enforced with the help of criminal law is acknowledged, a question must be raised on which moral regime the legal rules should be based on. In the case of a multicultural society, this issue may provoke many doubts.

The difficulty with deciding what the scope of morality is may lead to a conclusion that justifies all binding regulations. It just requires the adequate formulation of the moral objectives that are protected. And moral justification in many cases may be found *ex post*, after enactment of the sanctioning act.[188] Such an approach in practice allows for the application of criminal law to regulate all social phenomena but it also seems to overextend the scope of the notion of morality. It may be discussed that the use of the notion of a *Rechtsgut* should be applied instead.[189]

Another, more moderated version of legal moralism does not allow for a wide application of justification *ex post*. It requires that "*the criminal sanction should ordinarily be limited to conduct that is viewed, without significant social dissent, as immoral. The calendar of crimes should not be enlarged beyond that point and, as views about morality shift, should be contracted.*"[190] Thus, the starting point for discussion on criminalisation is the common opinion about morality of behaviour.

One may consider that limiting criminalisation to moral vices is unfounded because different systems of morality coexist nowadays and looking for the moral principles shared by everyone is fruitless. But it should be kept in mind that, if criminal law regulations are not supported by the community's shared opinion on justice, they may underpin the "moral authority of the criminal law"[191] and in consequence provoke an increase in the number of committed offences. Even if one does not agree on the unification of law and morality, it should be remembered that an enacted law cannot ignore the widely accepted moral rules. Otherwise, it risks being seen as unjust or even as a tool of oppression.

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[187] ASHWORTH, Andrew, *Principles of Criminal Law,* 4th edition, Oxford University Press 2003, p. 42.

[188] HYMAN, Gross, *A Theory of Criminal Justice*, Routledge, 1979, pp. 13–15.

[189] See point 5 below.

[190] PACKER, Herbert L., *The Limits of the Criminal Sanction*, 1969, p. 264, citation after: CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 6.

[191] ROBINSON, Paul H., DARLEY, John M., *The Role of Deterrence in the Formulation of Criminal Law Rules : At Its Worst When Doing Its Best*, The Georgetown Law Journal, 2003, Vol. 91, p. 953.

This concern should lead to the analysis of the "moral minimum" that lies at the foundation of the society (even multicultural) and requires protection with a help of criminal law.[192] In order to find the moral minimum that could serve as an indication of criminalisation the most justified solution seems to be the reference to protection of the basic human rights of others. At first glance, it may seem to be too narrow to assure the proper protection of the morality. But if one accepts the multicultural character of modern societies and realises that the other moral rules are derived from the basic human rights or have an auxiliary character and they enforcement with the help of legal tools would provoke more disaccords by forcing the point of view of only a part of the society, the usefulness of a reference to the human rights should be accepted. Thus, the issue of this moral minimum is in fact analysed in the section dedicated to the protection of the human rights.[193]

Nevertheless, even if the principle of legal moralism (whether in its wider or narrower version) is applied, it does not give an unambiguous basis for criminalisation of insider dealing. As it was shown in Chapter 1, in spite of the popular picture of insider dealing as something intrinsically wrong, an opposite view may also be defended. There are many arguments that refer to the morality and demonstrate that insider dealing is perfectly in conformity with the standards set by moral requirements. Nonetheless, some authors express the opinion that the moral wrongfulness of insider dealing should prevail while deciding about its criminalisation even if there were no other arguments and economic analysis would demonstrate its effectiveness for the market performance.[194] Such an opinion is difficult to accept even for the scholars strongly attached to the morality of laws.[195] On the other hand, some authors consider that the market phenomena are morally neutral.[196] Thus, if one wants to consistently apply the theory of punishment based on moralism, their criminalisation should not take place.

3 Harm Principle Theory

The theory of wrongfulness based on the harm principle has gained its biggest popularity in the common law systems. For many specialists, in criminal law, this

[192] The "ethical minimum" that every law includes: JELLINEK, Georg, *Die Sozialistische Bedeutung von Recht, Staat und Strafe*, 1878, Wien, p. 42, cited in: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 19.

[193] See point 6 below.

[194] STRUDLER, Alan, ORTS, Eric W., *Moral Principles in the Law of Insider Trading*, Texas Law Review, 1999, Vol. 78, No. 2, pp. 375–438.

[195] E.g. GREEN, Stuart P., *Cheating*, Law and Philosophy, 2004, Vol. 23, p. 177.

[196] KADISH, Stanford H., *Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations*, The University of Chicago Law Review, 1963, Vol. 30, p. 427.

principle is "*the starting point of any discussion of criminalisation*".[197] John Stuart Mill established the basis of the harm principle in his essay "On Liberty" under the name of "Principle of Liberty".[198] It was based on the assumption that any use of force by the state is justified only if it is an answer for a harm done to the other community's members. Thus, everyone should be allowed to do all one wants as long as it does not harm other persons. The alleged immorality of the conduct (in the eyes of the others) or provoking harm to the actor himself is not a sufficient reason for the application of criminal prosecution.

Joel Feinberg developed and structured John Stuart Mill's idea in twentieth century. Analysing the harm-based application of criminal law he rejected legal paternalism and legal moralism as sufficient reasons for criminalisation (although he did not exclude criminalisation on their basis if other conditions were fulfilled).[199] The definition proposed by Joel Feinberg is more moderate. In his opinion; harm is not a sufficient base for the application of the criminal law. Beside the element of "harm to others" in order to criminalise a given conduct the second condition must be fulfilled. Namely: "*there is no other means that is equally effective at no greater cost to other values*".[200] Thus, Joel Feinberg's approach refers to the second step of criminalisation, i.e. use of the principles of criminalisation.

The usefulness of the notion of harm for the purposes of criminalisation requires some analysis. Otherwise it risks being too ambiguous and instead of limiting the scope of application of criminal law, it may serve as a pretext for the introduction of numerous regulations. The following issues should be examined: definition of harm, the link between harm suffered and its author, intensity of the harm that justifies the criminal sanctions and definition of the victim.

a) Definition of Harm

The first and most intuitive understanding of the notion of harm is that it is a direct physical or mental injury or damage suffered by an individual. Such a definition would limit importantly the applicability of the criminal law. It would exclude, e.g. the possibility of criminalisation of acts like theft where no direct injury to the victim takes place. Thus, another description of this notion was needed.

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[197] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 32.

[198] MILL, John Stuart, *On Liberty*, Batoche Books, Kitchener, 2001.

[199] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 32.

[200] FEINBERG, Joel, *Harmless Wrongdoing – The Moral Limits of the Criminal Law*, Oxford University Press, 1988, p. xix, citation after: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts,* Springer, 2007, p. 13.

The definition proposed by Andrew Ashworth states that harm should be understood as "violations of people's legitimate interests".[201] But this definition expands the notion of harm if not excessively, obviously beyond the limits of the traditional understanding of the notion of harm. It proposes a new understanding of the concept of harm that does not reflect the meaning of the original notion. In fact, it refers rather to the liberal theory of wrongfulness based on violation of basic human rights.[202] If, still, it is accepted that the notions of harm and interests are interchangeable the importance of the notion of "legitimate" should be underlined. This approach calls for the setting aside of the subjective forms of harm that someone may claim to suffer but which should not justify the intervention of criminal law. For example, an enterprise may, in the opinion of other market players, harm its competitors by decreasing the prices of the offered services. However, as far as any of the competitors does not exploit any unjust means, does not violate the market rules, i.e. does not violate legitimate interests of others, there is no harm that would justify the application of a criminal regulation.

Another definition of harm tries to expand its scope outside the concept of damage. According to it, any kind of harm can be characterized as a "'*set-back', [. . .], a detriment or loss with more lasting consequences or a more lasting change to worse*".[203] But, still, some interpretative issues remain. It should be noted that if the notion of harm is applied too widely, it may become useless because it could be found everywhere and justify the introduction of any prohibition under the façade of harm-prevention. On the contrary, a too narrow definition may be detrimental for the proper application of criminal law as well. The idea of "set-back" does not give a precise indication concerning its limits. There is little doubt about the harm that relates to physical integrity. Also the violation of someone's property rights constitutes harm. But an action that leads to the loss of value of someone's property (without intentional destroying it) can provoke more doubts on the actual harm suffered by the owner.[204]

The next step in analysing the notion of harm is whether the psychological harm is also a sufficient basis for criminalisation. In case of insider dealing, one of the main claims against it is that it undermines the trust of investors in the market. Beside the issue of whether it really has such an effect on market players, one may ask if it is the kind of harm that justifies the intervention of criminal law.

In relation to market activities the application of criminal law should also take into account the specific rules that govern it. One of them is the economical freedom of undertaking the activities that let individual to achieve benefits. This liberty can be limited by the legislative powers but this limitation "*must have in view the good*

[201] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 33.

[202] See point 6 below.

[203] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 67.

[204] For more details see Sect. C.II.6, Chap. 1.

of the citizens as a whole rather than the interests of a particular class".[205] Of course, it does not mean that economic and personal rights are of a different kind. On the contrary, one supports the other and limitation in one domain leads to limitation of the second one.[206]

b) Causation

The next element of the harm principle is the character of the link between the conduct of the actor and the harm. There are many theories of causality[207] and choosing one of them determines how remote the act itself from the harm can be as well as what level of probability that a given behaviour could provoke harm is sufficient to criminalise this conduct.

The theory of adequate causation seems to be the most popular and accepted. It makes a distinction between the factors that regularly provoke a certain consequence and the others that may also lead to the same results but it happens only under special, unusual circumstances. Only the former group contains the factors that are acknowledged as "causes" of a given result.[208] Besides, the issue of the link between a conduct and harm in other's rights raises another question. Practically every action undertaken by an individual can be claimed by someone else to be harmful. Opening of a new grocery shop on the street may be harmful for another shop-owner. Thus, in light of the other principles and especially the principle of subsidiarity, harm has to be defined as sufficiently serious to justify the application of criminal law.[209] All the more, on the basis of the harm principle, criminal law cannot be applied to the conduct that creates only a mere risk of harm. If a given behaviour does not hurt anyone, but some think that it may, under some circumstances, be harmful, the behaviour should be described in a way that allows for the extraction of the actually harmful behaviour from a range of similar acts that are not harmful at all. Criminalisation applied to the whole group of harmful and not harmful activities means either the negligence of the legislature, who did not try to describe the harmful behaviour properly, or focused on other objectives to

[205] Justice Sam ERVIN in case *State v. Balance*, 51 S.E.2d (N.C. 1949) at 735 cited in: DELLINGER, Walter, *The Indivisibility of Economic Rights and Personal Liberty*, 2003–2004 Cato Supreme Court Review, 2004, p. 15.

[206] But some authors consider the economic rights as the prerequisite for all other freedoms. This opinion does not mean that economic freedoms cannot be limited in any way. For more details see: von HAYEK, Friedrich August, *The Road to Serfdom*, London : The Institute of Economic Affairs, 2001, p. 110.

[207] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 41.

[208] For more details on this theory see: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 43.

[209] Similar conclusion in: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, pp. 85–86.

criminalise such behaviour, maybe political, and not just on the will of reduction of harm that might be suffered by individuals.

c) Intensity of Suffered Harm

Another feature of the analysed notion concerns the intensity of harm that would justify the criminalisation of behaviour. If one agrees that some conducts, such as listening to loud music by a neighbour, may provoke some harm but are not harmful enough to apply criminal law to them, an issue arises about what is the minimal level of harm that makes criminalisation of a given act reasonable.

"*Minor or trivial harms are harms despite their magnitude and triviality, but below a certain threshold they are not to count as harms for the purposes of the harm principle, for legal interference with trivia is likely to cause more harm that it prevents*."[210] Unfortunately it is very difficult to determine the border between trivial and non-trivial harms. For that reason, if the approach based on the harm principle is accepted, the reference to the second step, i.e. principles of criminalisation, may help determine the appropriateness of the criminal law application.

d) Victim's Identity

The harm principle presupposes that harm, in order to justify application of criminal law, relates "to others". Thus, a proper definition of "others" is necessary. According to the liberal theory of the criminal law, the only victim that can claim protection of the criminal law is a human being – an individual whose possibility to make use of his rights has been violated.[211]

The issue whether criminal law's objective can be the protection against a harm done to the society seems to be questionable. It is difficult to demonstrate the values that belong to the society and not to the individuals who constitute it.[212]

Nevertheless, other approaches are also possible. For instance, the environment may be presented as a victim of pollution.[213] Another theory is based on a notion of "victimless crimes". It is used when the definition of the criminal offence does not allow to determine who was harmed by the wrongful behaviour but still, in opinion of some authors, the need of criminalisation exists. Many of the modern

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[210] FEINBERG, Joel, *The Moral Limits of the Criminal Law: Harm to Others*, Oxford University Press, 1984, p. 36.

[211] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 51.

[212] Similarly: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, pp. 51–52.

[213] WIENER, A. Imre, *Economic Criminal Offences*, Budapest, 1990, p. 49.

white-collar crimes are called "victimless" because they aim at protecting the general notions of "market integrity", "fair market", etc. and cannot show anyone hurt by the criminalised acts.

e) Conclusion

Mill's idea concerning punishment as a reply to the harm caused to others, by its simplicity, seems to be attractive and give clear indications concerning the evaluation of wrongfulness of an act. But when a more profound analysis begins, the notion of harm becomes less clear and requires numerous additional explanations. It may be applied in a strict way and refer only to the direct damages or be transformed into a tool used in search of any possible, even the most remote harm. How exactly should it be then understood? These concerns blur the usefulness of this theory and lead to its potential abuse. The theory of harm may be successfully used only if some additional complementary notes are added. Thus, the most justified solution seems to be the application of the harm principle if harm is understood not only as a direct injury but as a violation of the justified natural rights of every individual. In such a way this principle seems to be understood by most of the scholars.[214] Nevertheless there has been a switch in the understanding of the notion and a new meaning has been given to the notion of harm. It may then be proposed to name things properly[215] instead of disguising them as other notions.

If, however, one decides to apply the theory of wrongfulness based on harm principle, a few questions may be asked. In case of insider dealing, one has to verify whether this conduct fulfils all the elements of this theory of wrongfulness, i.e. if it provokes harm which is sufficiently direct and of sufficient intensity. The problems begin with the first element of the analysis, i.e. the harm itself. It is very difficult to show precisely what kind of harm insider dealing causes. The general notions like "lose of confidence to the market" seem to be quite weak when compared with the notion of harm applied in the other domains of the criminal law where it relates to the deprivation of life, freedom or property.[216] Doubts also arise when trying to distinguish those who are directly harmed by this kind of conduct. The group seems to be very imprecise and even authors disagree whether it is a victimless offence or whether victims are simply too dispersed to be potentially indicated.[217] In consequence, the harmfulness of this kind of behaviour may be proved only if the notion of harm is widely extended and the interpretation aiming at proving its

[214] E.g. see ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 33.

[215] See point 6 below.

[216] For a further analysis of the potential harms and benefits of insider dealing, see Sect. B, Chap. 1.

[217] ENGELEN Peter-Jan, LIEDERKERKE Luc V., *The Ethics of Insider Trading Revisited*, Journal of Business Ethics, 2007, No. 74, pp. 497–507, STERNBERG, Elaine, *Just business: Business Ethics in Action*, Oxford University Press, 2002.

wrongfulness is conducted. But such a use of this theory resembles the brothers Grimm's version of the Cinderella where the bad sisters cut their toes and heel just in order to suit the Cinderella's slipper.

4 Paternalism

Legal paternalism is one of the basic theories that allow qualifying given behaviour as wrongful.[218] As its name suggests, it assumes that legislature is a *pater familias* who takes care of his family, i.e. the governed community, and decides what kind of behaviour is permissible. In consequence, paternalistic theory defines as wrongful behaviour anything that may provoke the harm to the actor himself. According to this theory, a statement about the harmfulness of given behaviour to the actor is a sufficient condition to apply criminal law.[219] But this theory may be softened by a liberal approach and consider the application of non-criminal legal means to deal with an unwanted issue.[220] Moreover, it should be underlined that according to paternalistic theory, the legal interference into one's autonomy is limited to protection of the actual interests and not in creating of the interests that the one should have. Such a theory allows, e.g. for the criminalisation of the driving without seatbelts, basing on an assumption that it may save one's life in case of an accident. Paternalistic approach may be found in Article 8 of the ECoHR, which allows legally interfering into one's private and family life if it "*is necessary in a democratic society [. . .] for the protection of health or morals*".[221]

The opponents to this theory underline that it undermines personal autonomy and does not treat individuals as responsible agents that are able to take decisions concerning their lives. Moreover, they underline that this theory allows to dangerously extend the limits of the application of criminal law (or of any other sanctioning system).[222] As a result, the expansion of legal interference into individual's life may become uncontrollable.

It should be also noted that the theory of paternalism can be applied in relation to so-called "white collar offences" only to very small extent. Normally there are no actions that may provoke any kind of harm to their author. Alleged wrongdoer's behaviour is not susceptible to be painful or dangerous. Especially in relation to insider dealing, one is undertaking the actions that he is entitled to make when he is

[218] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 4.

[219] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 17.

[220] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, p. 18, referring to the law Commission.

[221] European Convention on Human Rights as amended by Protocol No. 14, Article 8.2.

[222] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, pp. 43–44.

not in possession of inside information (i.e. dealing in financial instruments). The only difference between legal and illegal activity is his knowledge relating to some securities.

5 *Rechtsgut* Theory

German criminal law theory not only influences Europe but also plays an important role in the Latin American and Asian countries. Moreover, its growing popularity may be noticed in the common law countries.[223] One of its main achievements is the *Rechtsgut* theory. The notion of *Rechtsgut* means a "legal good"[224] or a "legally protected good"[225] and was coined by Johann Birnbaum in 1834, and afterwards developed by Karl Binding, Rudolf von Ihering, and Frantz von Liszt.[226]

According to this theory, the objective of the criminal law is to protect the *Rechtsgüter*.[227] Thus, in order to properly apply criminal law, it must first be stated that the analysed behaviour violates a determined *Rechtsgut*.

In consequence, the main issue is to identify the *Rechtsgüter* properly. Unfortunately there is no clear answer to this question of how they should be distinguished and delimitated. The applied definition varies depending on the author. Within the scope of this theory there may be distinguished numerous variations. Different German authors define *Rechtsgüter* in a different way and, consequently, present different examples of practical application of the notion.[228] For example, Hans-Heinrich Jescheck and Thomas Weigend divide legal goods into those that are legal goods because of their nature and those that become legal goods when they are introduced into the legal order. The former are "*indispensable for the coexistence of humans in community and therefore must be protected by the coercive power of the state through the public punishment*".[229] One may found among them human life,

[223] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, pp. 679–680 and mentioned there legal works.

[224] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 681.

[225] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 106.

[226] GARDOCKI, Lech, *Zagadnienia teorii kryminalizacji*, Warszawa, 1990, p. 45.

[227] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, pp. 683–684.

[228] Ex. ROXIN, Claus, *Strafrecht: Allgemeiner Teil* I, 1997, pp. 11–12, JESCHECK, Hans-Heinrich, WEIGEND, Thomas, *Lehrbuch des Strafrechts : Allgemeiner Teil*, 1996, pp. 104–105 cited in: DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, pp. 684–685.

[229] JESCHECK, Hans-Heinrich, WEIGEND, Thomas, *Lehrbuch des Strafrechts : Allgemeiner Teil*, 1996, pp. 104–105 cited in : DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 684.

bodily integrity, but also traffic safety. The second group of *Rechtsgüter* "*consists exclusively of the deeply rooted ethical convictions of society*".[230] Another definition was proposed by Claus Roxin who declared that "*Legal goods are conditions or chosen ends, which are useful either to the individual or his free development within the context of an overall social system based on this objective, or to the functioning of the system itself*".[231] He noticed, however, that even if all determined interests are worthy of protection, not all of them should be protected through the use of criminal law. This idea constitutes a basis of the theory of the fragmentary character of the criminal law.[232] The theory presumes that criminal law does not cover all domains of the legitimate interests of individuals but only some (a fragment) of them. For Claus Roxin the limits of worthy protection *Rechtsgüter* are delimitated by the personal freedoms mentioned in the Constitution.[233]

As it was demonstrated above, just on two basic examples, the scope of the protection within this theory can be very far-reaching. Legal goods may refer to individuals but also to legal entities or even communities. Moreover, they may be material or immaterial, may aim at the protection of natural resources (such as water) or the results of the human labour.[234] They all have in common that they are recognised by the law as worthy of protection. It only depends on the kind of theory that is used. Some of them allow creating new *Rechtsgüter* in a practically unlimited way. In consequence, if there is only will to regulate something with a sanctioning regulation, there are always legitimate values and interests that would require protection of a new law.[235] Moreover, "positivist" version of the theory assumes that a *Rechtsgut* can be found in binding rules of law *ex post*. Consequently, it allows for the creation of *Rechtsgüter* just as an additional justification for already enacted prohibitions.[236] On the other hand, it should be noted that the mere existence of a *Rechtsgut* and the will of its protection do not mean that

[230] JESCHECK, Hans-Heinrich, WEIGEND, Thomas, *Lehrbuch des Strafrechts : Allgemeiner Teil*, 1996, pp. 104–105 cited in : DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 684.

[231] ROXIN, Claus, *Strafrecht: Allgemeiner Teil I*, 1997, p. 15, cited in: DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 685.

[232] JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio),* Ohio State Journal of Criminal Law, 2005, Vol. 2, p. 526.

[233] ROXIN, Claus, *Strafrecht: Allgemeiner Teil I,* 1997, p. 15, cited in: : DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 689.

[234] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 104.

[235] Similar objection: JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio),* Ohio State Journal of Criminal Law, 2005, Vol. 2, p. 524.

[236] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, pp. 107–108.

criminal law should be applied. Other means, such as civil or administrative law may be more apt to deal with the issue.[237]

There may be noticed some setbacks that discourage to use of *Rechtsgut* theory as a first step of criminalisation of given behaviour. The flexible nature of *Rechtsgüter* justified the introduction many different criminal rules that were not aiming at protection of individual rights but also at the protection of collective interests and the state itself.[238] As Knut Amelung noticed it,[239] Johann Birnbaum introduced the notion of Rechtsgut in order to widen the possible application of criminal law. The philosophers of the age of Enlightenment limited its scope of application. They claimed that only the violation of the natural human rights justify introduction of the criminal rules. Meanwhile, the theory of *Rechtsgut* lets the legislature decide what the *Rechtsgut* is and apply it in order to criminalise various domains of human activity. In consequence, there would be no illegitimate criminal offences in the positive law because for all of them a *Rechtsgut* may be found.[240]

One cannot accept the positivist *Rechtsgut* theory because it does not contain any indication about the proper shape of the criminal law rule. Its main objective is to analyse the existing rules and find in them the objects that are protected. All theories that enable the creation *Rechtsgüter* risk to be abused, because they may lead to unlimited creation of new legal goods that at a given moment seem to need legal protection. In consequence, the theory would not limit the enactment of new criminal rules but only serve as their "scientific" justification.

The version of the theory that refers to the principles declared in the Constitution or in the whole underlying legal system, tries to limit the above-mentioned risk of the overuse of the notion of a legal good. However, it may be noticed that such an approach seems to create a superfluity and does not to bring its own legislative significance. Relying on constitutional rights (i.e. those that can be found in already existing constitution-level acts) in order to justify some rules means looking for a justification in already existing positive law.[241] The Constitutional principles are already binding, thus there is no need to search for a supplementary theory in order to apply them. Otherwise one is creating additional legal constructions instead of simply applying directly the Constitution.

Moreover, an opinion could be found that the weakness of Constitution-based *Rechtsgut* theory is that the Constitutions do not contain all the rights that should be

[237] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 692.

[238] DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law,* The American Journal of Comparative Law, 2005, Vol. 53, No. 3, pp. 687–688.

[239] AMELUNG, Knut, *Rechtsgüterschutz und Schutz der Gesellschaft*, 1972, pp. 4–5, 237, 247 presented in: GARDOCKI, Lech, *Zagadnienia teorii kryminalizacji*, Warszawa, 1990, pp. 46–47.

[240] DUBBER, Markus Dirk*, The Promise of German Criminal Law: A Science of Crime and Punishment*, German Law Journal, 2005, Vol. 6, No. 7, p. 1069.

[241] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 117.

protected by the law.[242] Such limitation of the possible *Rechtsgüter* that should be protected would in fact mean a reference to legal positivism and a legal analysis based only on existing regulations.

In relation to insider dealing, before its criminalisation one should ask a question about the kind of the legal good this behaviour violates. And according to the accepted theory of *Rechtsgüter* the achieved results may vary importantly. If the notion of legal good is derived from the Constitution, one has to limit his researches to the rights mentioned there. If the concept is accepted that *Rechtsgüter* are the basic rights and freedoms of individuals, then only the behaviours that impair them may be considered to be wrongful. But if a wide version of the theory is applied, various legal goods may be created and new criminal provisions enacted in order to protect them. Such a wide notion of a *Rechtsgut* includes the protection of the trust that market players should have in the markets or the protection of performance of the stock exchanges. Thus, it is visible that this theory of wrongfulness may provoke some problems while evaluating given behaviour.

6 Liberal Theory of Wrongfulness

The analysis of the theories of the wrongfulness presented above shows that practically all of them might be applied in many different ways, depending on the approach taken by their user. One of the possible options of application is making a reference to the personal rights and freedoms of individuals. In consequence, harm may be understood as a violation of basic human rights, different schools of morality may find a common "nucleus" that relates to the rights of individual, finally the *Rechtsgut* theory may also perceive them as goods that should be legally protected. A question may be then asked on whether these rights should not constitute an independent theory of wrongfulness.

Reference to human rights and freedoms faces one serious problem. Namely, what are human rights? The application of criminal law in order to punish human rights violation requires precise rules that allow indicating the wrongful behaviour. The broad notion of human rights and their continuous extension do not give the solid basis for determination of the scope of criminal rules. The most basic definition states that: "*Human rights are rights which a person enjoys by virtue of being human, without any supplementary condition being requested*."[243] But it still does not define their content. The identification of human rights has been made through a long process. The ancient philosophers and medieval theologians discussed already the existence of a natural moral order and the rights of individuals. It should be remembered that it was Christianity that brought to the world the notion of equality

[242] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 109.

[243] TOMUSCHAT, Christian, *Human Rights Between Idealism and Realism*, Oxford University Press, 2008, p. 3.

between all human beings.[244] But it was not till seventeenth and eighteenth century when the idea of the human rights took its concrete shape. In "Two Treatises of Government" John Locke expressed the opinion that individuals possess natural rights which are independent from the political recognition granted them by the state. These natural rights covered the rights to life, liberty and property.[245] John Locke's contemporary, Immanuel Kant, developed another theory of human rights that influences the modern understanding of the notion. It is based on the assumption that human beings are equal and rational. Thus, human rights are perceived as the basis of self-determination founded on a reference to the human reason.[246] His philosophy formulates an objective of universality and application of rules that would bound all rational individuals.

The formal introduction of the human rights recognised at those times into legislative acts was made in the United States Declaration of Independence and the Virginia Declaration of Rights of 1776, and in Europe in the French Declaration of the Rights of Man and of the Citizen of 1789. Afterwards, the idea of human rights spread all over the world, especially in other European countries.

Karel Vasak described this development as the first generation of the human rights.[247] The next generations developed, respectively in 1945 and afterwards, in the second half of the twentieth century. And this development, or extension of the notion, may still be observed nowadays, at the beginning of the twenty-first century. According to the author of this division, the development of the human rights and its three generations make an analogy to the three mottos of the French Revolution: *Liberté, Egalité, Fraternité*. Thus, the first generation rights were based on the notion of freedom; the second generation was aiming at reduction of the social differences between individuals, at social and economic rights such as right to work or social security. Finally, the third generation, which is considered to be still emerging, refers to the welfare of the mankind and notions like right to development or to healthy environment.[248] Thus, the second and third generation of rights concentrate on positive obligations that the state has towards the citizens (second generation) or even that should be imposed on both state and whole community (third generation).

[244] E.g. Letter of Saint Paul to Galatian, 3:28, see also KUŹNIAR, Roman, *Prawa człowieka – prawo, instytucje, stosunki międzynarodowe*, Scholar, 2008, pp. 19ff.

[245] LOCKE, John, *Two Treatises of Government*, available at http://www.efm.bris.ac.uk/het/locke/government.pdf.

[246] FAGAN, Andrew, *Human Rights,* Internet Encyclopaedia of Philosophy, http://www.iep.utm.edu/hum-rts/.

[247] VASAK, Karel, *A 30-Year Struggle*, The UNESCO Courier, November 1977, p. 29, presented in: TOMUSCHAT, Christian, *Human Rights Between Idealism and Realism*, Oxford University Press, 2008, p. 25.

[248] TOMUSCHAT, Christian, *Human Rights Between Idealism and Realism*, Oxford University Press, 2008, pp. 54–60.

The parallel between the age of Enlightenment motto and three generations of human rights, although catchy, oversimplifies the issue. As it has been demonstrated the notion of equality was developed already by Immanuel Kant and expressed in the eighteenth century acts. It may be rather observed that the first generation rights refer to the individual in his relation to the state (governor) and try to restrict its interference with human lives. They express the feeling of power that one can have over his fortune and life. Meanwhile, the next generations of human rights loose this positive approach and treat one as incapable to "pursue happiness"[249] alone. The state engages into activity that aims at bringing welfare to everyone. This approach seems to interfere with an optimistic vision of age of Enlightenment authors who believed in the individual development of every person. Besides, if it is agreed that the second and third generation human rights' objective is to enforce the fraternity between the society's members, one may wonder if such an objective is feasible. As it was noted already in 1850 by Frédéric Bastiat: "*Mr. de Lamartine once wrote to me thusly: "Your doctrine is only the half of my program. You have stopped at liberty; I go on to fraternity." I answered him: "The second half of your program will destroy the first." In fact, it is impossible for me to separate the word fraternity from the word voluntary. I cannot possibly understand how fraternity can be legally enforced without liberty being legally destroyed, and thus justice being legally trampled underfoot.*"[250] This radical opinion, although seemingly justified in relation to the second and third generation human rights, does not take into account an important issue. According to Kantian philosophy, fraternity may be understood as respect of the dignity of others. This approach does not impose any immediate solutions but only limits the notion of freedom (or liberty) to "*doing anything which does not harm others: thus, the exercise of the natural rights of each man has only those borders which assure other members of the society the enjoyment of these same rights.*"[251]

In order not to apply criminal law too vaguely, it seems justified to draw a precise line that would separate the core of the human rights from other rights.[252] The opinion can be defended that proper application of criminal law should be limited only to protect the basic human rights that belong to the first generation. The difference between them and other, more recent ones, is immense.[253]

Firstly, the presence of the basic human rights may be traced throughout human history, while the existence of the second and third generation rights can be dated

[249] According to the notions of the United States Declaration of Independence of 4 July 1776.

[250] BASTIAT, Frédéric, *The Law*, Foundation for Economic Education Irvington-on-Hudson, New York, 1998, pp. 21–22 (emphasis omitted).

[251] Declaration of the Rights of Man and of the Citizen, Article IV.

[252] Philipp BAGUS calls them "pseudo human rights" in: *Human Rights Inflation and Property Rights Devaluation*, 13 October 2008, published on: http://www.independent.org/students/essay/essay.asp?id=2341.

[253] See: BAGUS, Philipp, *Human Rights Inflation and Property Rights Devaluation*, 13 October 2008, published on: http://www.independent.org/students/essay/essay.asp?id=2341.

back to the mid twentieth century. The core human rights are universal; they are binding in all jurisdictions even if they are not expressly present in the binding laws.[254] Meanwhile the "new" human rights are binding only in the states that recognise them in the legal system. The basic human rights are precise and clear: they focus on an individual: his life, liberty, property. The new generations of human rights are very often not precise. For instance the right to social insurance does not determine the scope of the due social services or the age at which they should be paid. This vagueness provokes also concerns related to their contradictory character. The right to education and right to medical care may not be fully realised in a state with a limited budged. Meanwhile, classical human rights, e.g. right to life and private property, create a coherent system that protects individuals. Finally, the basic human rights aim at the restriction of the state's powers in relation to an individual. On the contrary, second and third generation of human rights increases the spheres of the state's intervention. This may result in limitation of the core human rights, i.e. in limitation of the one's freedom.

It may be stated that the theory of wrongfulness that refers to the protection of the basic human rights may be also called "liberal". This name would refer to the doctrine created in the eighteenth century by John Locke, i.e. liberalism, and developed afterwards by many great philosophers. Already its name is derived from the Latin word "*libertas*" meaning "freedom". The importance of the liberal theory cannot be undermined till the modern times.

In the United States the notion of liberalism, which was attributed to one of the governing parties, is often substituted by a notion of libertarianism.[255] The definition of libertarianism is that it "*oppose[s] every excessive form of government authority*" and "*all government intrusions into the lives of individuals are inherently suspicious and require justification, particularly when authorities seek to deprive human liberty*".[256]

Both European liberals and American libertarians concentrate on the human being as a fundament of their analysis. They refer to the Enlightenment tradition of individualism and personal liberty. This central position of the human being, characterised by free will and dignity, requires a special approach while enacting new rules. This leads to the Kantian theory which demands that the state and its laws should address its citizens as responsible moral agents.[257] Moreover, the state's intervention cannot be based on well-being of other persons or society in general because that would also violate another Kantian rule that individuals should

[254] On this basis the wrongfulness of the crimes against humanity that took place in twentieth century could be declared.

[255] In this context: LUNA, Eric, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 730.

[256] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 730, emphasis omitted.

[257] DUFF, Anthony, *Legal Punishment*, in: Stanford Encyclopaedia of Philosophy, accessible at http://plato.stanford.edu/entries/legal-punishment/.

be treated as ends and not merely means. The notion of "responsible moral agent" assumes that an individual acts according to his free will. As long as he does not impair the rights of others, he can do or not do with his body and personality whatever he wants.[258] In consequence, the law should reflect this idea. Focusing on the individual autonomy of everybody, it should respect the fact that each person has the right to pursue his own model of life and intervene only to create the minimal limits securing the basic rights of other persons.[259]

The liberal theory of criminal law seeks a balance between the two main objectives: protection of individual rights and prevention of crime.[260]

The Kantian originating principle is also known as "the principle of individual autonomy".[261] Its opponents consider that free will of an individual is not in fact so free and that everyone is determined by the circumstances that they cannot control. This quite pessimistic vision of the human condition is mitigated by a less definite approach that, although there are some cases when one's actions are so strongly determined that the element of free will practically disappears, the notion of the personal liberty to undertake a given action should be always analysed seriously.

The result of such an approach is that the state can intervene only when an individual infringes the rule of personal freedom, by imposing his will on another person and violating the individual's rights. And the state's intervention, i.e. the penalty it can impose on an individual, has to reflect the degree of the violation of another's rights. It means that the punishment has to be focused on restoring of the violated order and be proportionate to the actor's wrongdoing.[262] If the state undertakes actions that infringe this limitation, its actions are unjust. Finally, the limitation of the state's powers is accompanied with the notion of the rule of law. It means that the state, even acting within the scope of its obligations, has to respect the principles that legitimise its actions.[263]

If one accepts the liberal theory of wrongfulness it becomes obvious that the wrongfulness may be declared only in relation to the acts that violate individual rights. Thus, the concept of victimless crime is incompatible with the liberal understanding of the crime as a violation of somebody's rights.[264] Simply, if

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[258] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 732.

[259] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 43.

[260] DWORKIN, Ronald, *Taking Rights Seriously*, Harvard University Press, Cambridge, Massachusetts, 1977, p. 12.

[261] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, pp.28–30 and the literature there cited.

[262] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 734.

[263] LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 736.

[264] Similar conclusions in: LUNA, Erik, *The Overcriminalization Phenomenon*, American University Law Review, 2005, Vol. 54, p. 738.

there are no victims, it is difficult to talk about a violation of one's rights. Such a statement excludes the possibility of application of criminal law, but does not exclude the need of legislative intervention with a help of another legal tool, e.g. an act of parliament based on administrative or civil law.

It should be also underlined that the liberal theory of wrongfulness allows application of criminal law exclusively to an act that directly violates the rights of others. It is a natural consequence of the fact that the criminal punishment always infringes the basic rights of the offender. A behaviour that provokes a mere risk of violation of another person's rights may be considered to be inappropriate and may, in consequence, merit intervention of a legislature but in such a case only other than criminal law tools may be used.

7 Conclusions

As it was presented above, there are many different approaches that aim at demonstration that the legislature intervention is needed in order to regulate a given behaviour. Each of them has a different scope of interests and, in consequence, may lead to different goals.

Legal positivism allows for the application of legal rules in any situation when the legislature finds it necessary. Moralism seeks for the violated moral rules and tries to transpose into the legal system the predominant moral order shared by the community. Harm based theory may be understood in many different ways. The first, narrowest version assumes that the notion of harm may be applied strictly and then it limits it only to direct damages and injuries suffered by individual. But the understanding of the notion may be applied according to the will and assessment of the wrongfulness made by the person who analyses it. In consequence, it may be understood as a violation of human rights but also extended to many various behaviours that are harmful only in opinion of the lawmakers. Paternalism extends the harm principle also to the author of the act himself. In that way it gives to the legislature the role of guardian of the community but also of the individuals against their own actions. The *Rechtsgut* theory seeks a scientific justification for the objectives (or goods) that should be protected by law. But it does not limit clearly these goods and also may encompass many various social phenomena.

For that reason, the most justified seems to be application of the liberal theory based on protection of the core human rights, i.e. the right to life, freedom and private property. These notions has been already analysed in the age of Enlightenment and their meaning and scope of the application is clear and limits the risk of the legislature's discretion.

In consequence, in relation to the behaviour that interferes with the functioning of the markets, legal intervention with the help of the criminal law would be needed only if the analysed act violates basic human rights of playing on the markets individuals. It could not be applied in order to protect general ideas like proper performance of market, trust of the market participants to the market, etc.

As for the other theories, legal positivism may lead to abuse of the law by the sovereign (the legislature): it does not impose any limits on the legislature that in consequence may create the laws which are properly enacted but treat individuals inhumanly. Moralism may be used as an attractive option if the legislature is acting in a name of a community which members share precisely the same system of the moral values. Otherwise, it may easily turn into a tyranny of the majority that imposes its convictions on other members of society. The paternalistic theory, by its intervention into the activities of an individual against himself does not treat him as a reasonable agent and master of himself. Again, it may lead to absurd regulations even if they are motivated by care for citizens and sincere conviction that the legislature knows better what is the best for individuals. Finally, the notion of the *Rechtsgüter* seems to be too flexible and risks being applied even *a posteriori* to already enacted acts, in order to justify their enactment. In consequence, its application may lead to increase and not decrease in the number of enacted prohibitions.

What should be underlined is that the application of the different theories in many cases would lead to similar conclusions. Usually, what is considered to be harmful is also immoral. Meanwhile not all immoralities provoke harm to anybody or to actor himself. Harm will also lead to violation of a personal right to physical integrity. The overlapping scope of the different theories is presented in Fig. 3.2.

II Principles of Criminalisation: Justifying Application and Determining the Proper Shape of the Criminal Law

The positive answer for the question on whether an analysed behaviour is wrongful does not imply automatic application of the criminal law. At this moment the next step of the proper criminalisation procedure should be taken. The goal of the state is to find the legal means that would achieve their goals but would not unnecessary limit individuals' freedom. Thus, when the need of legislative intervention is

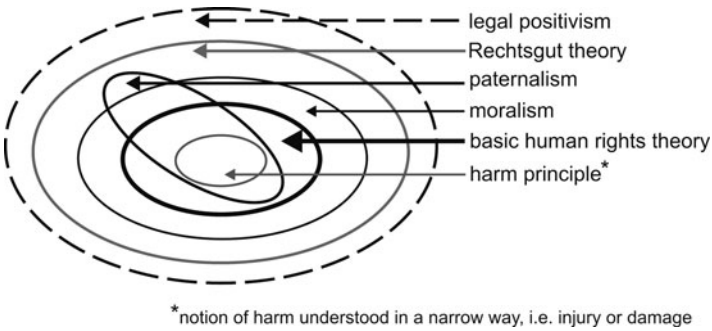

Fig. 3.2 Overlapping scopes of the different theories of criminalisation

acknowledged, the state's objective should be to check what legal solution would be most efficient and least intrusive into individuals' lives. In practice it means that criminal law is treated not as the unique tool that may be used in order to deal with an unwanted phenomenon, but as a one of the possible means, among administrative law and civil law. Moreover, the possibility of solving the problems with extralegal instruments, such as organisational codes of the various entities, should be also taken into consideration.

This part of the chapter presents the principles that provide indications on whether criminal law may be used or whether other branches of law may sufficiently deal with the wrongful behaviour. Moreover, because of their nature, some of the presented principles give additional guidance about the proper shape the criminal rules should have if the application of this most coercive branch of law appears to be necessary.

Different authors have various opinions on the aspects that should be analysed before a decision about the criminalisation is taken. According to Joel Feinberg, after it is ascertained that any given behaviour is harmful, it should be verified whether there are other means that may be applied in order to deal with the issue.[265] In the opinion of other authors, after verification of the wrongfulness of the behaviour (with the help of one accepted wrongfulness test) an analysis should be made in order to declare whether it is necessary to use criminal law and whether it is permissible to so.[266] Unfortunately, they do not present the definition of "necessity" as if it was evident. The notion of "permissibility" in this reasoning is understood as compatibility with the European Convention on Human Rights.[267] However, these two rules, and especially the first of them, seem imprecise. Necessity may be defined in many different ways and lead different persons to different conclusions. Without establishing more precise criteria, "necessity" may be used arbitrarily and in consequence transform criminal law into a frequently used tool.

Another approach that can be found examines whether the behaviours give an unfair advantage to the alleged wrongdoer. If they do so – criminal law may and should be applied. Unfortunately its effort to delimit the unacceptable behaviour leads eventually to "*deeper intuitive notion of what is fair and unfair*".[268] In consequence, it does not give clear indications that would help decide whether criminalisation is required, either. The notion of advantage should refer rather to the retributive theory of punishment that may underline the whole legal system but does not give precise indications when exactly criminal law should be applied.

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[265] FEINBERG, Joel, *Harmless Wrongdoing – The Moral Limits of the Criminal Law*, Oxford University Press, 1988, p. xix.

[266] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials,* London Sweet & Maxwell, 2003, pp. 18–25.

[267] CLARKSON, C.M.V., KEATING, H.M., *Criminal Law: Text and Materials*, London Sweet & Maxwell, 2003, pp. 18–25.

[268] GREEN, Stuart P., *Cheating*, Law and Philosophy, 2004, Vol. 23, p. 182.

Thus, more justified is the application of an approach based on numerous principles that take into account different aspects of the legal analysis. The approach proposed here is based on principles of criminalisation. It makes reference to the most basic notions of the criminal law tradition. The principles were developed by legal philosophers in the age of Enlightenment. Nevertheless, their roots may be found already in the earlier works of the philosophers analysing the notion of justice.

Principles may be defined as a kind of special purpose rules. Ronald Dworkin, when analysing the issue of difference between "normal legal rules" and principles, stated that the latter have "*the dimension of weight or importance*".[269] Thus, there should be made a distinction between these two groups. Both groups aim at setting the legal standards that should be applied in particular situation. But application of the legal rules is always done in an all-or-nothing way. A rule cannot be respected only partially. Moreover, it may be either valid or invalid. If two of them conflict, it means that one of them is invalid. Meanwhile, principles aim at establishment of the standards required by justice. They have a more general scope of application because they indicate the direction in favour of a given solution but do not determine the content of the decision. In some situations they may conflict. It does not mean that they are not valid but only requires more effort to find a solution that would realise the requirement of both concurring ideas.[270]

A question should be asked about the legal basis for the application of the principles of criminalisation. Their existence is not always declared *expressis verbis* in national laws. But it does not mean they do not have a normative value. Rules that should govern the process of criminalisation are the result of philosophical analysis. Many of them are present in the national laws on the constitutional level.[271] Thus, some authors speak about constitutional criminal law[272] as minimalist requirements that must be fulfilled when analysing the need of criminalisation. Meanwhile, some principles cannot be found in enacted acts and belong rather to the "legislative ethics"[273] and do not have a binding character. But even if they are not expressed in national regulations, they should influence the legislative because of their well established position in the theory of law. They reflect the achievements of the legal thought through the centuries and are as valuable as other discoveries made in various domains of human researches.

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[269] DWORKIN, Ronald, *Taking Rights Seriously*, Harvard University Press, Cambridge, Massachusetts, 1977, p. 26.

[270] DWORKIN, Ronald, *Taking Rights Seriously*, Harvard University Press, Cambridge, Massachusetts, 1977, p. 28.

[271] Such as the principle of proportionality in the Polish Constitution, article 31.3.

[272] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003.

[273] JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio)*, 2005, Ohio State Journal of Criminal Law, Vol. 2, p. 521.

What is important when a principles-oriented approach to criminalisation is taken is to base the analysis of the need of criminalisation on the properly chosen principles. The principles are like traffic signs, they orient towards the destination, but if they are applied wrongly, they may direct to a destination completely different than the one expected. Thus, if the objective of the legislature is to maintain and support a democratic, liberal society, the applied principles have to be compatible with its values.[274]

In the literature, the opinion can be found that the real development of the principles of criminalisation theory took place only in the Anglo-American legal systems.[275] Such a statement cannot be accepted. It is not based on any solid foundations. Although it may be agreed that the modern legal philosophy is well represented by the authors that come from the common law countries,[276] the influence of the continental Europe philosophers, such as Immanuel Kant or Charles de Montesquieu, and their legal theory, cannot be overvalued.

A question may be asked on whether principles of criminalisation are different in relation to acts relating to the different domains of the human activity. That would mean that criminalisation of the behaviours that are, for instance, linked to commercial activity should be based on different premises.[277] There is no reason for such an approach, if the opinion is accepted that the objective of the criminal law is to protect the life, liberty and property of an individual and that he should not be used as a tool to achieve other goals. Human rights should enjoy the same level of protection regardless of the sphere of the human activity. Such a statement applies also to the market activity and the business transactions.

The subsequent sections will present widely accepted principles of criminalisation. The principle of subsidiarity concentrates on criminal law as a tool that may be applied only when other legal means are insufficient to deal with the problematic behaviour. The principle of proportionality indicates the importance of both the application of the criminal law when it is able to achieve the established goals and the formulation of criminal rules that would respect the balance between the offence and the threatening penalties. Respect for the principle of legality requires proper formulation and enactment of the rules. Application of principle of culpability demonstrates the incompatibility of properly used criminal law and strict liability that does not require this subjective element. Finally, the principle of *in dubio pro libertate* gives a final indication while assessing the need of enactment of a criminal regulation. Moreover, there might be found different

[274] Similarly: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts,* Springer, 2007, p. 13.

[275] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, pp. 23 ff.

[276] Just to mention Ronald DWORKIN, H.L.A. HART, Andrew von HIRSCH.

[277] E.g. some authors distinguish special principles that should be applicable to this kind of criminalisation, see: ZAWŁOCKI, Robert, *Podstawy odpowiedzialności karnej za przestępstwa gospodarcze*, Warszawa 2004.

principles, such as efficacy or flexibility. However, they seem to have more importance for the state's criminal policy than for the proper use of criminal law.

Finally, an additional remark should be made. Almost each principle of criminalisation may be used only superfluously. In consequence its role would be reduced to being only a façade that would legitimate introduction of new rules. But such concern applies to all domains of human activity: if the law is taken seriously, each principle should be profoundly analysed and applied to the concrete issue.

1 Principle of Subsidiarity

Broadly speaking, the principle of subsidiarity assumes that the intervention of a higher rank entity should take place only if the treatment of the lower level is not enough to deal with a given issue.

In the case of criminal law, subsidiarity presumes that the intervention of criminal law is justified only if other branches of law are not able to solve the problems arising from the given behaviour. This limitation of application of criminal law and the special role it plays stem from the fact that it reflects the strongest powers a state can exercise towards its citizens. Therefore, such a kind of power should be used prudently.

The idea of subsidiarity can be found already in Aristotle's and Saint Thomas Aquinas' writings.[278] But it was in the age of Enlightenment that Jeremy Bentham developed it. He based on subsidiarity his utilitarian approach that required using means other than criminal law provided that they were sufficient to prevent the harm done to others.[279] The criminal law had a role which may be described in a Latin phrase *ultima ratio* – it should be applied when other legal means fail. Since the times of the first "utilitarians", the principle has gained wide acceptance and it has been consciously expressed in binding legal acts.[280]

It should be also underlined that the principle of subsidiarity (not only in relation to criminal law) belongs to the fundamental principles of the European Union. When applied to the criminal law (leaving aside the discussion about the competences of the European Union in the domain of criminalisation), it means that criminal law should not be applied on the European level as long as a given

[278] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 84.

[279] BENTHAM, Jeremy, *Introduction to the Principles of Morals and Legislation*, ch. 13, see also: ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 36.

[280] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 96.

issue is successfully dealt with by the Member States acting independently or in cooperation with each other.[281]

According to some authors the principle of subsidiarity in its *ultima ratio* meaning is derived from the principle of proportionality.[282] It seems, however, to be more justified to present the principles of subsidiarity and proportionality separately because, although interconnected, they express different ideas and the distinction between them is noticeable.

Although the notions of subisidiarity and *ultima ratio* are sometimes used interchangeably,[283] a more profound analysis underline that they do not have exactly the same meaning or that they refer to different characteristics of the basic principle. In the narrower sense, the principle of subsidiarity should be distinguished from the notion of *ultima ratio*. The former defines the conditions and scope of intervention of criminal law in order to regulate a given issue. The latter insists on a prudent application of criminal law that may be used only if other legal means are not sufficient.[284] In practice, it means that a criminal regulation should be introduced into a legal system only if there are no other legal means that could deal with the unwanted issue. Other possibilities, such as the application of the administrative or civil law, should be first analysed. Naturally, it does not mean that the state authorities should try all possible solutions in order to verify their usefulness before making a decision about criminalisation of a given conduct.[285] If such an understanding is accepted, the principle of subsidiarity is of a positive character: it allows for the application of criminal law when it is necessary. Meanwhile, the *ultima ratio* rule is of a negative character and prohibits the intervention as long as other means are available. The usefulness of such distinguishing seems to be, however, of a little practical value as both notions refer to the same concept of minimal possible intervention of criminal law into individuals' lives.

It should be underlined, however, that it does not mean that the principle of subsidiarity act only as a constraint to the legislatures will and creates an obstacle to criminalise a behaviour. It would act like this in case of the behaviours that do not violate core human rights and may be dealt with through the help of other means. In case of serious offences against individual's rights, the application of principle of

[281] Similarly HRYNIEWICZ, Elżbieta, *Europejskie przestępstwa, europejskie dobra prawne* in: SZWARC, Andrzej J., JOERDEN, Jan C. (editors), Europeizacja prawa karnego w Polsce i w Niemczech – Podstawy konstytucyjnoprawne, Poznań 2007, p. 64.

[282] ROXIN, Claus, *Strafrecht: Allgemeiner* Teil I, 1997, pp. 26–27, in: DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 692.

[283] E.g. by Nils JAREBORG in: *Criminalization as Last Resort (Ultima Ratio)*, Ohio State Journal of Criminal Law, 2005, Vol. 2, pp. 521–534.

[284] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 95.

[285] Similarly: ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 120.

subsidiarity underlines only that other than criminal law legal solutions are too weak to deal with them.[286]

A possible problem, linked with application of principle of subsidiarity, is that it does not give any indications about the limits which let criminal law apply properly.[287] In consequence, it can be easily violated by a legislature who claims, without taking into consideration other principles of criminalisation, that his decision about criminalisation was in a given situation necessary. The principle of subsidiarity itself does not contain any positive indication on what should be criminalised. It contains only a restriction that should be applied when a substantive reason for restricting a given human conduct has been found. Its proper application presumes that in such a situation, an evaluation should be made in order to verify whether it is the criminal law that should be applied in that case or maybe less intrusive ways of regulation would be sufficient. Nevertheless, it should be noted that the role of this principle is not to indicate the wrongful behaviour, because that has been already made in the first step of the criminalisation process. Now, it should be only decided what is the best legal tool that may serve to deal with the issue. And for such purpose, the principle of subsidiarity (accompanied by other principles) is sufficiently clear.

Among legal theoreticians the opinion is also expressed that criminal law should be applied as a *prima ratio*. In relation to the market phenomenon it is justified by the need to reduce the unwanted market behaviours and this claim underlines that the abstractive character of the threat a criminal rule creates does not interfere with the freedom of entrepreneurship.[288] This opinion cannot be supported for the following reasons: contrary to this opinion it is very difficult to create a criminal rule that does not interfere with the free market activities and moreover, every criminal rule interferes with the personal freedom of its addressees. Moreover, as it was demonstrated above,[289] deterrence cannot be the only objective of the criminal law, because its first objective should be the restoration of justice and punishment of the wrongdoer. Finally, a large number of the criminal offences would deprive criminal law of its special character and provoke the inflation of the criminal law. In consequence, instead of achieving their goals, the criminal rules would lose their special character. Thus, the application of principle of subsidiarity, in relation of all the domains of human activity, seems to be more justified.

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[286] Similarly: ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 122.

[287] ZAWŁOCKI, Robert, *Kryminalizacja obrotu gospodarczego w Polsce*, in: DUKIET – NAGÓRSKA, Teresa (ed.), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, p. 216.

[288] TIEDEMANN, Klaus, *Verfassungsrecht und Strafrecht*, Heidelberg, 1991, p. 52.

[289] See Sect. B, in this chapter.

2 Principle of Proportionality

The direct reference to the notion of proportionality can be already found in the writings of Cesare Beccaria and Jeremy Bentham.[290] However, their understanding of this principle was different from the one that is accepted now. They insisted on introducing criminal sanctions that would be the smallest possible and still would achieve their main goal, i.e. deterrence of the other members of the society from committing an offence similar to the one that had been punished. Hence, independently, they applied proportionality as a tool for their utilitarian theory of governing the members of the society on the basis of two basic feelings, i.e. pleasure and pain. Nevertheless, the principle was presented as a limitation to the powers of the state when imposing criminal sanctions on individuals. Also Montesquieu advocated the proportionality between crime and punishment and claimed that only the crimes that injured individuals should be punished severely. Basing on this statement, he criticised the crimes against the religion (like heresy) that existed at his times for not being in fact crimes as long as they did not infringe anyone's personal liberty.[291]

In the modern version the principle of proportionality was elaborated in the German law theory and then acknowledged in different legal systems. Its origins were derived from the principle of legality.[292] The creation of a criminal prohibition requires adequacy between the means used to achieve the objectives of regulation and the criminalised conduct.[293] The principle of proportionality should be understood twofold. First, it concerns the relation between the kind of the criminalised behaviour in terms of its seriousness and the severity of the penalty imposed in criminal proceeding. This rule applies to judges and their power to determine the scope of the penalties that would reflect the seriousness of the committed wrong. Excessive harshness or lenience of the penalty violates the principle. The second meaning refers to legislature and the need to keep balance between the mean and the goal. If criminal law is used, it should not provide sanctions that are too high, or too little. But respect for proportionality may also lead the legislature to apply another legal tool. The principle underlines that the legal rule is too harsh if less rigid legal means would suffice.[294]

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[290] BECCARIA, Cesare, *On Crimes and Punishments and Other Writings*, Ed. Richard Bellamy, Cambridge University Press, 1995, Chapter 12, BENTHAM, Jeremy, *An introduction to the Principles of Morals and Legislation*, 2000, Batoche Books, Chapter XIV.

[291] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 51.

[292] ROXIN, Claus, *Strafrecht: Allgemeiner* Teil I, 1997, pp. 26–27, in: DUBBER, Markus Dirk, *Theories of Crime and Punishment in German Criminal Law*, The American Journal of Comparative Law, 2005, Vol. 53, No. 3, p. 692.

[293] ZAWŁOCKI, Robert, *Kryminalizacja obrotu gospodarczego w Polsce*, in: DUKIET – NAGÓRSKA, Teresa (ed.), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, pp. 217–218.

[294] See also: JAREBORG, Nils, *Criminalization as Last Resort (Ultima Ratio)*, Ohio State Journal of Criminal Law, 2005, Vol. 2, p. 532.

On the European Union level, the principle, but only in relation to the scope of the inflicted penalties, can be found in Article 49 point 3 of the Charter of Fundamental Rights of the European Union.[295]

In the common law writings it is also called "*de minimis* principle",[296] and understood as a requirement that the wrongful behaviour in order to be criminalised should not be trivial. This assertion is based on a claim that limitation is necessary in order to restrict the abusive application of criminal law. Otherwise, the increasing number of criminal rules, regulating petty offences, may provoke the decrease in the respect that people have for this branch of law.

In the legal literature, it is pointed out that in fact the principle of proportionality is composed of three elements or smaller principles: the principle of rationality, the principle of necessity and the principle of proportionality *sensu stricto*.[297] They will be described in the subsections below.

a) Principle of Usefulness or Rationality

The principle of rationality implies that the legislature should choose those means or actions that are suitable to achieve the established goals. Within this postulate, two issues should be distinguished: usefulness of the criminalisation of a given behaviour and usefulness of a proposed punishment. In opinion of Krzysztof Wojtyczek, the principle of usefulness means that a criminal punishment may by justified only if it is able to achieve the chosen social goals. Thus, on this basis he considers that principle of proportionality rejects the retributive role of punishment.[298] Such an approach does not seem acceptable. The goal set by the legislature may be to punish justly those who violate a given rule. Consequently, the realisation of this objective would be proportional (as far as the penalty does not exceed its objective) and still based on retributive theory of punishment.

The task to verify *ex ante* whether the proposed regulation is able to deal with the described problem and achieve its goal is always based on hypothetical assumptions and burdened with a risk of an error. What might have seemed justified and proper in a given context may turn out to be ineffective. Nevertheless, the legislature should try to examine whether any other, less infringing the basic rights

[295] It may be noted that without any necessity, the formulation of the principle is made through double negation "penalties must not be disproportionate" while the simple "penalties must be proportionate" would be clear enough.

[296] ASHWORTH, Andrew, *Principles of Criminal Law*, 4th edition, Oxford University Press 2003, p. 33, who mentions this principle after the authors of the American Model Penal Code.

[297] WOJTYCZEK, Krzysztof, *Zasada proporcjonalności jako granica prawa karania*, in: ZOLL, Andrzej (ed.), Racjonalna reforma prawa karnego, Warsaw 2001, p. 297ff.

[298] WOJTYCZEK, Krzysztof, *Zasada proporcjonalności jako granica prawa karania*, in: ZOLL, Andrzej (ed.), Racjonalna reforma prawa karnego, Warsaw 2001, p. 298.

of individuals, possibilities of punishment exit.[299] And the criminal regulation, as well as the scope of the punishment applied, can be used only when this test shows no less intrusive but sufficiently efficient alternative.

b) Principle of Necessity

The principle of necessity requires that the chosen means should be the least burdensome for an individual. Consequently, the principle is violated if the same effects could have been achieved using the means that do not interfere so strongly with the liberties of the individuals. The practical difficulty stemming from this rule is to analyse not only all possible alternative penalties but also their capacity to deal with the issue. Such an evaluation may again be very difficult. Moreover, the principle does not give any indication on how to proceed in a situation when a non-criminal penalty is slightly less effective but also causing fewer nuisances in the individuals' life than a criminal punishment. And even within the same kind of punishment, the comparison of short term imprisonment to a large pecuniary penalty may provoke some doubts as to their strictness.

c) Principle of Proportionality *Sensu Stricto*

The core of the principle of proportionality is addressed to the legislature and those who apply the law. It requires the adequate relation between the outcome of the regulation and the obligations put on the citizens.

The principle of proportionality requires that the protected rights of individual cannot be of a smaller importance than rights that are limited by the introduced regulation. Criminal rules influence the most important rights of individuals – their liberty, dignity, property. Thus, it cannot be used to protect the goods (or *Rechtsgüter* according to the *Rechtsgut* theory) that do not have a similar significance. The fact that the core human rights risk here being limited confirms the necessity to apply the theory of wrongfulness based on the basic human rights violation.

It should be noted that the test conducted in order to verify the proportionality of the proposed legal construction is based on the value that is attached to the different criteria that are taken into account. If for a legislature, protection against the risky market behaviours is more important than violation of the rights of an individual, in spite of the application of this principle, the outcome would be in favour of

[299] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, pp. 80–81.

criminalisation.[300] Thus, application of the principle requires proper predetermination of the most important values that should be protected by criminal law. Such predetermination should be made by reference to the notion of the basic human rights of individuals.[301] Otherwise, if other notions are considered to be more important than these rights, one risks creating a society that favours the abstract concepts of welfare, security, etc., over the concrete dignity of every human being.

Moreover, the principle of proportionality requires keeping balance between all crimes defined within a legal system. A murder cannot be punished less severely than shoplifting, because the former crime is against the most precious good a human being possesses, i.e. life, while the latter impairs "only" someone's property. The same rule should be applied in the domain of the white-collar crimes. Meanwhile, it is often very difficult to compare the corporate and classical offences as well as the white-collar crimes between them.[302]

In order to apply the principle of proportionality to insider dealing and analyse the need of legislative intervention an evaluation should be made on what is the influence of this behaviour on the market and how its prohibition would be perceived by the market players. A new criminal regulation might be acceptable if it improved the market performance and only if the "losses" provoked by insider dealing could be qualified as violations of basic human rights of other market players.

3 Principle of Legality

The principle of legality constitutes one of the foundations of the legal order of modern states. It guarantees the security from unpredictable state's intervention into individuals' lives. The origins of this principle cannot be easily indicated and many possible sources may be mentioned, including the English Magna Carta of 1215. But it was the Austrian law of 1787 that first adopted this principle *expressis verbis*.[303]

The principle is in fact composed of two elements that can be expressed in the phrase *nullum crimen, nulla poena sine lege* ("no crime, no punishment in the absence of the criminal statute"). The first of them provides that a legislative act that introduces a criminal rule has to determine precisely the scope of the

[300] Similar concerns expresses Peter-Alexis ALBRECHT in: ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, p. 84.

[301] Described in section dedicated to the liberal theory of wrongfulness, Sect. C.I.6, in this chapter.

[302] The maximal criminal penalty imposed for insider dealing according to the Polish regulation is the same as in the case of conscious putting someone into a danger of HIV contamination (Polish Act of Parliament of 6 June 1997 - Criminal Code, Article 161 paragraph 1).

[303] More on a history of the principle in: GLASER, Stefan, *Nullum Crimen Sine Lege*, Journal of Comparative Legislation and International Law, 1942, Vol. 24, No. 1, pp. 29–37.

prohibition. Moreover, in order to punish an act, the legal prohibition of this behaviour has to be binding before the act is committed. The objective of the second part is to describe precisely the penalties that may be applied when the rule was violated. Thus, a judge cannot apply the penalties that are not described in criminal regulations or are out of the range provided by the law (even if there were more lenient for the offender).[304]

The existence of the properly formulated criminal rule protects an innocent against discretionally power of prosecution and a judge. "*It is the undeniable right of every man to know what acts are allowed and what forbidden, what acts the law consider useful, what harmful and what indifferent*."[305] This principle is also recognised on the European Union level in Article 49 point 1 and 2 of the Charter of Fundamental Rights of the European Union.

The principle of legality in the countries of the common law tradition is often called the rule of law. According to Lon L. Fuller this principle is composed of the eight principles that inhere its total meaning: generality, promulgation, nonretroactivity, clarity, noncontradiction, possibility of compliance, constancy through time, congruence between official action and declared rule.[306]

The part of the definition that relates to the temporal application of the criminal statute does not usually provoke doubts as regards its interpretation (at least in the domain of the insider dealing regulation). However, the requirement of clear formulation needs some additional attention. It can be analysed on the main two levels – proper formulation that delimits the scope of the prohibition and the fulfilling of the procedural requirements during the process of the creation of a new law.

a) Proper Formulation

Precise determination of the scope of the prohibition presupposes that the rule that creates prohibition must be interpreted strictly.[307]

According to the long-established principles of criminal law, a criminal rule has to be both precise and unambiguous. This requirement has been confirmed by the

[304] The obligation of proper defining of criminal conduct and the penalties may are also known as the principle of certainity, see ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, p. 49ff.

[305] GLASER, Stefan, *Nullum Crimen Sine Lege*, Journal of Comparative Legislation and International Law, 1942, Vol. 24, No. 1, p. 34.

[306] DYZENHAUS, David, *The Rule of Law as the Rule of Liberal Principle*, in: RIPSTEIN, Arthur (ed.), Ronald Dworkin, Cambridge University Press, 2007, p. 72.

[307] SPIELMANN, Dean, SPIELMANN, Alphonse, *Droit pénal général luxembourgeois*, Bruylant Bruxelles, 2004, p. 96.

case-law of the ECHR.[308] It means that a simple lecture of the criminal law should enable individuals to distinguish the wrongful behaviour from a one falling outside the application of the criminal rule and, in consequence, perfectly legal.

A rule of criminal law has to define clearly the forbidden conduct and let everyone distinguish what kind of behaviour falls under the prohibition and what is allowed (*nullum crimen sine lega certa et stricta*). This principle imposes on the legislature two main obligations. First, the scope of the prohibition, thus the forbidden act, has to be defined precisely. Secondly, criminal rule should cover all the scope of the behaviour that is considered to be wrongful.

Insider dealing falls into the category of offences that requires a definition of the whole economic behaviour in order to limit the scope of prohibition. Not only are there many different acts that may be included into the scope of the notion of "insider dealing", but also some of them are practically undetectable for the prosecution. For instance, in a situation when an insider on a basis of inside information decides not to sell his financial instruments even if he had wanted to do so before he learnt about the new circumstances. Such a case always remains beyond the scope of the insider dealing prohibition. Nevertheless, it is composed of all the elements of the offence of insider dealing – an insider uses inside information before it is disclosed to the public. Thus, the practical scope of prohibition and prosecution is always narrower than the scope of actual behaviours that constitute insider dealing *per se*. It may provoke some doubts about the utility of the insider dealing regulation.[309] The most astonishing situation exists under American law where insider dealing is not defined at all and the scope of the prohibition has been regularly changing following the interpretations proposed by the SEC and the case-law.[310] Such changes obviously do not protect individuals. Whether an act constitutes the breach of the insider dealing prohibition or not may be declared *post factum* and lead to one's criminal liability.

As it was indicated in Chapter 1, which analyses the wording of the Market Abuse Directive, other elements of the prohibition introduced in the act may likewise provoke doubts from the point of view of the proper criminal regulation. Problems begin with the first definition of the Directive containing the notion of the "precise character" of the information.[311] As an excuse for the European legislature it may be said that the formulation of the Directive relates only to a basic administrative prohibition of the conduct. Member States, if they want to criminalise it, should

[308] SPIELMANN, Dean, SPIELMANN, Alphonse, *Droit pénal général luxembourgeois*, Bruylant Bruxelles, 2004, p. 44 and cited there case-law cases.

[309] An observation may be applied that: *"if a law declares a practice to be criminal, and cannot apply its policy with consistency, its moral effect is necessarily weakened."* FREUND, Legislative Regulation 253 (1932), citation after: KADISH, Stanford H., *Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations*, The University of Chicago Law Review, 1963, Vol. 30, p. 437.

[310] For more details please see Sect. B.II, Chap. 1.

[311] Market Abuse Directive, Article 1.1.

consider the principles of the proper criminalisation on their own. However, in practice, many national laws regulating insider dealing are based on the precise wording of the Market Abuse Directive.[312] Such an approach is caused by a will of transposition the Directive into the national laws without deforming its objectives and with maintaining maximal harmonisation between the Member States. Nevertheless, it defines the wrongful conduct in an extremely broad way, imposing the prohibition not only on individuals that act on a basis of inside information but reaches much further and implies liability of those who presumably should have known that given information was not disclosed to the public.[313] In consequence, the limits of the prohibition are blurred and left to the personal evaluation of the whole case by the prosecution or the judge.

b) Proper Legislation

Another aspect of the principle of legality is the power of the competent entity to enact a document that would be the source of the obligation for individuals. Since the times of Montesquieu, the distinction between three separate sources of the state's power – legislative, executing and judicial is considered to reflect the principles of democratic state.[314] This division reflected the idea that the legislative body is entitled to issue laws on a basis of the legitimacy given by the citizens in the election.

However, the creation of the European Community, succeeded by the European Union and its increasing activity in many domains that were traditionally attributed to the national governments has blurred this division. Basing on the CJUE judicial decision of 13 September 2005,[315] the European institutions found them entitled to impose on Member States the instructions in the domain of the criminal law. Entry into force of the TEU and TFEU strengthened this position. In consequence, the mechanism of creation of criminal law was treated similarly as any other domain of the European Union activity. And that means that introduction of the criminal rules may be the result of the administrative decisions with no democratic support.[316] Of course one may express the opinion that the procedure according to which the European Union law is enacted is, at least partly, democratic because of the role that the European Parliament, chosen in the direct pan-European elections, plays in the

[312] See presentation of the Luxembourg and Polish national regulations in Sect. C, Chap. 2.

[313] Market Abuse Directive, Article 4.

[314] GARLICKI, Leszek, *Polskie prawo konstytucyjne Zarys wykładu*, Liber Warszawa 1999, p. 72.

[315] CJEU, 13 September 2005, *Commission of the European Communities v Council of the European Union*, C-176/03.

[316] BRAUM, Stefan, *Program Haski Unii Europejskiej – właściwe i niewłaściwe priorytety europejskiej ewolucji prawa karnego,* in: SZWARC, Andrzej J., JOERDEN, Jan C. (eds.), Europeizacja prawa karnego w Polsce i w Niemczech – Podstawy konstytucyjnoprawne, Poznań 2007, pp. 17–19.

whole procedure. Nevertheless, the role of the Parliament in the enactment is limited and it cannot decide about the shape of the new laws. Thus, its position is not comparable to the national parliaments, which have full control over the shape of the issued laws. But, if the entitlement of the European institutions to issue the laws that require creation of national criminal rules is accepted, the national parliaments would be reduced to a role of mere executors of the will of the structures of the European Union.[317]

The supporters of wide competences of the European Union consider that the basic freedoms expressed in the European law have their impact on all domains of the life of the European Union citizens. Consequently, there should be no differentiation between criminal law and its other branches like fiscal or social. Thus, they believe that insisting on the empowerment of the national legislative bodies to create the criminal rules only reflects the old-fashioned way of thinking and is not justified.[318]

The opponents of such an approach insist on the importance of the *nullum crimen sine lege parlamentaria* principle and underline that the criminal law, because of its potential impact on the freedoms of an individual, must have democratic origins.[319]

This discussion is of a great importance in regard to the criminalisation of insider dealing because the Market Abuse Directive contains direct indication, although not obligation, for Member States to introduce the criminal regulation of this behaviour. This kind of "encouragement" does not have an obligatory character and cannot even be mentioned as an example of a criminal rule introduced on a European Union level. But, in spite of the fact that it is only a recommendation, many Member States may fill obligated by such a formulation to introduce new criminal rules into their legal systems.

[317] HEFENDEHL, Roland, *ETS stawia na głowie przyporządkowanie kompetencji w zakresie prawa karnego – i dziwi się krytyce*, in: SZWARC, Andrzej J., JOERDEN, Jan C. (eds.), Europeizacja prawa karnego w Polsce i w Niemczech – Podstawy konstytucyjnoprawne, Poznań 2007, p. 59 and the literature there mentioned.

[318] Presentation of the opinion of the judge of the ECUE V. Scouris made after: HEFENDEHl, Roland, *ETS stawia na głowie przyporządkowanie kompetencji w zakresie prawa karnego – i dziwi się krytyce*, in: SZWARC, Andrzej J., JOERDEN, Jan C. (eds.), Europeizacja prawa karnego w Polsce i w Niemczech – Podstawy konstytucyjnoprawne, Poznań 2007, p. 45.

[319] LÜDERSSEN, K, FUCHS, H., SCHÜNEMANN, B., opinions presented in: HEFENDEHL, Roland, *ETS stawia na głowie przyporządkowanie kompetencji w zakresie prawa karnego – i dziwi się krytyce*, in: SZWARC, Andrzej J., JOERDEN, Jan C. (editors), Europeizacja prawa karnego w Polsce i w Niemczech – Podstawy konstytucyjnoprawne, Poznań 2007, p. 45.

4 Principle of Culpability

One of the traditional principles of the criminal law states that a human behaviour should be punished only if the wrongdoer is morally responsible for his action, i.e. if his culpability can be proved.[320] It implies creation of the criminal rules that provide the element of the culpability in their wording. This statement can be undermined in the era of the increasing role played by strict liability offences. These offences do not require any subjective element. In order to be liable, one has only to fulfil objectively the description of wrongful behaviour. The strict liability offences are easier to detect and prosecute because they do not require a proof of a personal will while committing a crime but only evidence of the fact that the elements of the offence that can be found in its definition were realised. Some authors consider that attachment to the idea of culpability is only a remaining of the old law schools.[321] However, in order to keep the characteristic of criminal law and not to blur its distinction from other branches of law, the notion of culpability should be applied as one of the constitutive elements of the offences. Otherwise, there would be no difference between the administrative proceeding, which by definition verifies only the fulfilment of the requirements of the law, and criminal trials.

When the importance of the principle of culpability is accepted, it becomes evident that the freedom of an individual cannot be sacrificed in order to fulfil state's social objectives.[322] The imposition of a legal penalty must reflect the personal attitude of the wrongdoer (i.e. his culpability) and the wrongfulness of the conduct (according to the accepted theory of wrongfulness). According to some authors, the principle of culpability, alongside with the harm principle, constitutes a basis to evaluate the seriousness of an act.[323] But it is rather a result of the strong attachment to the harm principle. The culpability itself plays an important and independent role, regardless the accepted theory of wrongfulness.

The principle of culpability refers to a strictly subjective notion of a personal attitude towards the committed wrong. There are many different theories that try to define it.[324] Psychological theories are focused on personal attitude towards the act. Meanwhile the normative theories focus on the violation of the rules of proper

[320] JAREBORG, Nils, *What Kind of Criminal Law Do We Want?,* in: SNARE, Annika (ed.), Beware of Punishment, Oslo, Pax Forlag, 1995, p. 24.

[321] ZEDNER, Lucia, *Criminal Justice*, Oxford, Oxford University Press, 2005, p. 61.

[322] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, p. 72.

[323] Von HIRSCH, Andrew, *Desert and White-Collar Criminality: A Response to Dr. Braithwaite*, The Journal of Criminal Law and Criminology, 1982, Vol. 73, no. 3, p. 1167.

[324] BOJARSKI, Tadeusz, Commentary to Article 1 of the Polish Criminal Code in: *Kodeks karny Komentarz*, BOJARSKI, Tadeusz (ed.), Warszawa 2009, pp.26-28, WĄSEK, Andrzej, KULIK, Marek, Commentary to Article 1 of the Polish Criminal Code in: *Kodeks Karny Komentarz*, FILAR, Marian (ed.), Warszawa 2010, pp. 20–22.

conduct. Therefore, they refer to criteria such as "what would a reasonable man do in given situation". Unfortunately, instead of facilitating the analysis they in fact blur the distinction between intentional and unintentional actions. All committed acts are evaluated without taking into consideration the real motivation of the actor. Most justified seems to be the use of a combined theory which observes the improperness of behaviour but also tries to analyse the psychological relation between the wrongdoer and the act.[325]

The description of insider dealing in the Market Abuse Directive does not refer to the notion of culpability. It is understandable because the Directive is establishing the rules for administrative regulation of the issue. Nevertheless, it should be underlined that proper introduction of a criminal rule to a national legal system should give it such a shape that would include the element of *culpa* into the legal analysis of the breach.

5 *In dubio pro libertate*

The in *dubio pro libertate* principle is derived from the trial principle of *in dubio pro reo*.[326] The latter rule reflects the idea that no one should suffer punishment more severe that what would be adequate according to the evidence gathered in the proceeding against him and that all doubts should be decided in favour of the accused. Meanwhile, *in dubio pro libertate* in the domain of criminalisation presumes that if there are any justified doubts concerning the need of criminalisation of a given conduct, it means that criminal law should not be applied. Criminalisation in order to be justified has to be necessary. But it does not preclude the application of another way of the social control, such as administrative or civil law.

The principle creates an obligation to justify the need of criminalisation and allocates the burden of proof on those who propose the new criminal regulation. The same idea can be also expressed by the Latin phrase *in dubio contra delictum*.[327] A question may be asked on whether this principle has its own normative value or is it just a natural result of the analysis of a given conduct made on a basis of other principles. It seems that its presence among other principles of criminalisation underlines the importance of the issue and gives it an independent normative value. In case of an evaluation of relevant behaviour,

[325] BOJARSKI, Tadeusz, commentary to Article 1 of the Polish Criminal Code in: BOJARSKI, Tadeusz (ed.), *Kodeks karny Komentarz*, Warszawa 2009, p. 28.

[326] Opinion presented in 1959 by Ulrich KLUG can be found in: HANACK, Ernst-Walter, *Zur Revision des Sexualstrafrechts in der Bundesrepublik*, Hamburg, 1969, p. 37 and KLUG, Ulrich, *Rechtsphilosophische und rechtspolitische Probleme des Sexualstrafrechts*, in: Skeptische Rechtsphilosophie und humanes Strafrecht, Part 2, Berlin 1981, p. 179 ff, for more information see also: GARDOCKI, Lech, *Zarys teorii kryminalizacji*, Warszawa 1990, pp. 138–139.

[327] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 76.

many different aspects are taken into account. As they are analysed separately, in *dubio contra delictum* principle may help to look on the object of analysis from a different point and answer the general question about the need of criminalisation.

The opponents of this principle consider that the use of such a rule would in fact put other persons in peril. In their opinion, the application of this principle means that in case of doubt there is no protection for victims of the wrongful behaviours. But this claim is unfounded. In case where criminal law is not applied other means of social control may be used. A more justified argument refers to the source of the principle, i.e. the *in dubio pro reo* rule that is applied by courts. It underlines that application of the *in dubio contra delictum* rule cannot assume the same level of certainness as in case of judicial verdict. A judge decides on the basis of precise information concerning an act that has been already committed. Its consequences and circumstances are already known. Meanwhile, the decision about criminalisation is always taken on a hypothetical basis and cannot be supported by strong empirical evidences.[328] Nonetheless, the existence of estimations based only on probability does not mean that an act should not be criminalised. The principle underlines the need of proper concern and justification when introduction of a new criminal rule to the legal system is planned.

The application of this principle to insider dealing would help decide whether the application of the criminal law to deal with the issue is really necessary. All arguments that concern the alleged wrongfulness of this behaviour, the opinions that defend it, individual rights that it violates (if any), other methods that may possibly limit its influence and occurrence on the markets should be taken into account. It is only on this basis that a justified and well-founded decision about the criminalisation of insider dealing can be made and, as the principle indicates, in case of well-founded doubt, other means of control should be considered.

6 Other Principles and Rules

As it was already said, there is not only one model version of the principles of criminalisation. Moreover, different authors introduce their own proposition as well as try to establish their own hierarchy between them. In legal literature too, other propositions of principles of criminalisation can be found. Some authors consider that the application of criminal law to the different domains of human activity requires application of additional rules, or principles, of criminalisation. That would mean that criminalisation of the wrongful behaviours in the domain of market activity should be based on a different basis than criminalisation in domain of non-professional relationships between members of the society. This argument, if the approach to criminal law oriented on freedom is taken, cannot be supported. Basic human rights protection should be the same in all the spheres of the human activity.

[328] Discussion on the principle can be found in: GARDOCKI, Lech, *Zarys teorii kryminalizacji*, Warszawa 1990, pp. 138–148.

Nonetheless, additional principles demonstrate the concerns and potential issues that may arise from application of criminal law. These principles take into account other, usually practical, concerns that arise while creating a new criminal rule. It should be, however, underlined that they should not be prevailing while taking decision about introduction of a new legal rule. Simply, they do not relate to the main objective of the criminal law.

a) The Cost-Benefit Analysis

The name of this rule recalls the economic deterrence-based estimation of the proper penalties for the offences made for the purposes of the utilitarian, deterrence-based theory.[329] However, at the last stage of the criminalising procedure, it relates to more general notions of the criminal policy.

Before a new criminal rule is enacted, one may try to draw an analysis that predicts the positive and negative effects of introduction of a new criminal rule.[330] Such estimations would include the financial costs of a new rule. As it was mentioned, enactment of a new criminal statute does not entail immediate expenditures for the state's budget. However, in the long term, the state has to face the increase of expenses on police, prosecution, penitentiary system and finally (and hopefully) on state's aids for reintroduction of ex-prisoners to the society. On the other hand, it may calculate the benefits, i.e. the losses that were avoided thanks to the reduced rate of the unwanted behaviour. This analysis should also take into account the social benefits and losses.

The examination includes the costs that can be easily attributed to criminal proceeding: costs of prosecution, judicial expenses, administrative costs of imprisonment, etc. But it should also take into consideration other more subtle social charges, like impact on families, employment prospects of the sentenced and other aspects, like deterrence.[331] The importance of those additional costs cannot be neglected in the domain of the white-collar crimes. The analyses show that the offenders from this group are particularly vulnerable to the negative consequences arising from being an addressee of a criminal verdict. The effects are often irrevocable.[332] When one is considered to be a "criminal" his professional and personal life may be destroyed.

[329] See Sect. B.I.1 of this chapter.

[330] SCHONSHECK, Jonathan, *On criminalization. An essay in the philosophy of the criminal law*, 1994, Kluwer, Dordrecht-Boston-London, PERŠAK, Nina, Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts, Springer, 2007, pp. 92–94.

[331] BROWN, Darryl K., *Cost-Benefit Analysis in Criminal Law*, 2004, California Law Review, Vol. 92, No. 2, p. 344.

[332] BAER, Miriam H., *Linkage and the Deterrence of Corporate Fraud*, Virginia Law Review, 2008, Vol. 94, 2008; Brooklyn Law School, Legal Studies Paper No. 123. Available at SSRN: http://ssrn.com/abstract=1290710, p. 1312.

Just because of these all costs arising from the introduction of a criminal rule, the application of the criminal law is the most expensive way to control the society, not only because of the direct expenses, but also because it is burdened with many other social costs.

The cost-benefice analysis should not be treated as a one of the principles of criminalisation that may lead to abandoning a decision regarding introduction of a criminal rule. The objective of the application of criminal law is not to reduce the state's expenses but to protect the individuals against violation of their personal rights. Thus, although some economic analysis may be useful to avoid the unneeded use of criminal law (important increase in the state's expenses may be more convincing for politicians than reference to the more intangible principles of criminalisation), the final decision should be principles-oriented and choose not the least expensive solutions but those that protect the best the individuals' rights. Criminal policy should demonstrate the predominance of the values over the mechanical economic rationality.[333]

b) Principle of Efficacy

Application of the principle of efficacy arises from the state's criminal policy. Before introducing a new criminal rule to market regulation, an analysis should be made on whether this rule could be effectively realised and respected.[334] Introduction of rules whose detection and prosecution is practically impossible diminishes the respect for criminal law. Of course one may wonder whether such obstacles should lead to resignation from introducing of a new regulation. The opinion may be defended that a probable small efficacy of a criminal rule should not prevail while deciding about not-criminalisation of a wrongful conduct. However, in order to protect the due respect the criminal law should have, in situation when the efficacy of the rule might be marginal, other means of social control should be taken into consideration.

c) Principle of Flexibility

The principle of flexibility is based on the assumption that the most important for the market participants is to resolve the conflict between the wrongdoer and his victim. Thus, criminal law should be applied, generally, at the request of the

[333] Similarly : CHAPUT, Yves, *La pénalisation du droit des affaires: vrai constat et fausses rumeurs*, Pouvoirs, 2001/1, No. 128, p. 92.

[334] ZAWŁOCKI, Robert, *Kryminalizacja obrotu gospodarczego w Polsce*, in: DUKIET – NAGÓRSKA, Teresa (ed.), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, p. 218.

victim.[335] Naturally, an individual would refer to criminal regulation only when other means to resolve the conflict have not succeeded and the help of the state's authority is needed. Such a solution would spare the unnecessary budgetary costs. Criminal procedure would be launched only if a victim considers it unavoidable.

At first glance, this principle seems to be reasonable. However, in practice it may lead to overuse of criminal law. Simply, creation of criminal rules, applicable on demand of the victim of the unwanted behaviour, may be treated by the legislature as creation of an additional way for individuals to fight for their rights. Such an approach is incompatible with the human rights-oriented theory of criminal law. It also demonstrates the lack of confidence in other means of resolution of disputes between the community members.

Moreover, as it was presented in Chapter 1, this principle could have only a limited application to insider dealing. Simply, there is no clearly defined victim, and mentioned generally "market fairness" does not give a power to act on behalf of any particular person. Unsurprisingly, application of this principle only demonstrates the lack of the usefulness of the insider dealing regulation for the market. If the opinion is accepted that criminal law in the domain of the white collar crimes should be applied only on demand of the victim, the non-existence of the latter makes doubtful the whole concept of the criminal statute.

D Conclusions

"*Man is born free*" Jean-Jacques Rousseau stated.[336] Freedom, as a prerequisite for human fulfilment, is one of the foundations of the human inter-reactions within society. The other two are the right to life and personal property. The violation of these basic human rights and their subordination to other social objectives lead to all terrible experiences of the twentieth century. It can be observed that Nazism or communist systems were based on the premise that security (from different factors that varied depending on the system's ideology) is more important than the rights of individual.[337]

According to the principles established in the age of Enlightenment, the criminal law should be applied only when at least one of the natural rights of an individual

[335] ZAWŁOCKI, Robert, *Kryminalizacja obrotu gospodarczego w Polsce*, in: DUKIET – NAGÓRSKA, Teresa (ed.), Zagadnienia współczesnej polityki kryminalnej, Bielsko – Biała, 2006, p. 218.

[336] ROUSSEAU, Jean-Jacques, *Du contrat social, ou, principes du droit politique*, 1962, Paris : Garnier Frères, p. 236.

[337] There are many books that describe the historical background of the anti-liberal revolutions. Very interesting presentation can be found in: von HAYEK, Friedrich August, *The Road to Serfdom*, London : The Institute of economic affairs, 2001, FROMM, Erich, *Ucieczka od wolności*, Warszawa, 1978, ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, pp. 17–45.

"*is violated in its core by someone else*."[338] The basic human rights oriented approach determines the shape of the state and scope of its possible intervention into individuals' lives. It is derived from the developed in the age of Enlightenment theory of social contract, based on a premise that individuals agreed, even if there was no official act that expressed this will, on the creation of an entity that could balance their need of protection. Thus, according to Kant's theory, the state loses its legitimacy if its actions are addressed against its "raison d'être": protection of the individuals who voluntarily delegated part of their powers in order to be protected.[339] But the scope of the justified protection is limited only to the fundamental human rights, i.e. right to life and physical integrity, freedom, right to personal property.[340]

Meanwhile, in spite of the painful experiences of the twentieth century, these foundations of the criminal policy have been forgotten. At the beginning of the twenty-first century, application of the criminal law is based rather on an assumption that it is a universal cure for numerous social problems. It is not limited anymore to traditional criminal notions like manslaughter, theft or kidnapping. Worldwide, criminal law is very often used as an answer to socially undesirable behaviours. Governments apply it now to various domains, such as protection of environment, consumer protection or competition law.[341] Criminalisation of insider dealing belongs also to this trend. Criminal laws are enacted on a basis of the short-term evaluation of the situation and they try to answer the urgent social pressure or are a result of the successful enforcement of the interests of a given social group. The number of criminal regulations increases, but, at the same time, the respect they command and their importance in the eyes of their addressees have significantly decreased.

A good sign for the future of the criminal law is that at least some politicians are aware of the importance of the proper creation of the criminal regulations. The following statement was presented in the British Parliament as an answer for a question: "*In considering whether new offences should be created, factors taken into account include whether:*

- *the behaviour in question is sufficiently serious to warrant intervention by the criminal law;*
- *the mischief could be dealt with under existing legislation or by using other remedies;*

[338] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, p. 49.

[339] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, pp. 22–24.

[340] These basic rights can be found already in the French Declaration of the Rights of Man and of the Citizen of 1789, see also: ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, p. 49.

[341] E.g. Article L.420-6 I of the French Commercial Code that provides criminal liability of persons engaged in abuse of dominant position.

– *the proposed offence is enforceable in practice;*
– *the proposed offence is tightly drawn and legally sound; and*
– *the proposed penalty is commensurate with the seriousness of the offence*."[342]

Although there is no reference to the basic human rights protection, at least this approach demonstrates some concern and reflection on application of the criminal law. And it should be only hoped that such a statement would be followed with the consistent criminalisation policy.

The objective of this chapter is to defend that principles-based application of the criminal law. As it was demonstrated, limitation of its use to the violations of the basic human rights would restore the balance between the different branches of law and would bring back the due respect and importance of the criminal law. The other theories of wrongfulness do not fulfil these criteria because they apply the criminal law too broadly (moralism) or their scope does not cover all situations when the intrinsic values are damaged (harm principle).

Moreover, the presentation of the principles of criminalisation, as a second-step leading to potential application of criminal law, showed how many requirements must be fulfilled in order to obtain a proper criminal rule. It should be properly enacted and clearly formulated. Criminal law should be applied only when the intensity of violation justifies it and when other means are not sufficient to deal with the issue. Besides, the applied penalties have to be proportional to the character of the breach and the subjective element of the person's behaviour – the culpability – has to be proved. The second step of the criminalisation assures that there are no unnecessary criminal laws. Because, in the same way that printing money does not solve the economic problems and leads to inflation, enacting new criminal laws does not fight the unwanted behaviour but impairs the respect that criminal law should have.

Of course there are other propositions of the principles-based criminalisation. Jonathan Schonshek[343] and Nina Peršak,[344] independently, propose three-step approaches.

Jonathan Schonsheck proposes criminalisation based on three filters: the Principles Filter, the Presumptions Filter and the Pragmatic Filter. The first one consists in verifying whether the moral authority of the state requires the introduction of a new norm. It refers directly to the legal moralism theory. Then the Presumption Filter has a role similar to that of the principle of subsidiarity. It

[342] Lord WILLIAMS of Mostyn (at that moment Minister of State) in a written answer to a question by Lord DHOLAKIA, H.L. Deb., Vol. 602, WA 57 (June 18, 1999) cited in: ASHWORTH, Andrew, *Is the Criminal Law a Lost Cause*, Law Quarterly Review, 2000, Vol. 116, p. 229.

[343] SCHONSHECK, Jonathan, *On criminalization. An essay in the philosophy of the criminal law*, 1994, Kluwer, Dordrecht-Boston-London, presented in: PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, pp. 92–94.

[344] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, pp. 92–94.

aims at the verification of whether there are other, less coercive than criminal, means of regulation that may be applied in given situation. Finally, the Pragmatics Filter is based on a cost/benefits analysis of the enactment and enforcement of a prohibition.

Nina Peršak, basing on the Schonsheck's three-filter theory, proposes another version of the "*ideal three-step criminalisation process*".[345] According to it, the first reference should be made to the harm principle. That would help to decide whether given behaviour is wrongful. At the second stage, the reference to the other – negative – principles should be made, such as the *ultima ratio* and legality principles as well as to the examination of whether other, less intrusive means could be applied. The last stage should consider the financial costs of criminalisation and enforcement, the social costs of criminalisation, practical achievability of enforcement, the effectiveness, the possible acceptation and willingness of people to obey the new rule, the consistency with the already existing law. The list includes also a possibility of taking into account also other, not mentioned, factors. This formulation provokes some doubts. Such an open character allows for the inclusion of additional elements that would lead to achievement of a specific, predetermined outcome. The third stage, in order to justify criminalisation, should demonstrate that the potential benefits outweigh the costs. However, Nina Peršak underlined that it should be kept in mind that the importance of the two stages is bigger than the last one. Thus, if an offence "passed" the requirements of the two steps, an increase in the state costs should not exclude the possibility of criminalisation. One may ask what the real value of the third stage is, if its content is not precise and its outcome in some cases is not prevailing for the criminalisation.

These two theories are based on a different first-step approach. One is based on moralism and the second on the harm principle. As it was demonstrated above, these two approaches lead to unsatisfactory results when determining the need of criminalisation. Thus, more justified seems to be a theory that is based on the core human rights protection as the first-stage criterion.

The two-step criminalisation theory gives a new perspective on applicability of criminal law to insider dealing. Figure 3.3 presents a schema which should be followed in order to answer a question whether criminal law may be applied to deal with an unwanted social phenomenon. As it may be easily seen, criminal law should be applied only in a case when the behaviour violates one of the core human rights and moreover it passes all the tests required by the principles of criminalisation.

As it was presented in Chapter 1, the economic analyses do not give a clear answer on how insider dealing influences the markets. The specialists do not agree on whether this behaviour brings more benefits or loses for other market participants. Some of them consider that insider dealing violates the right to private property. Meanwhile, others consider that such a statement is a fallacy. Thus, there

[345] PERŠAK, Nina, *Criminalising Harmful Conduct, The Harm Principle, its Limits and Continental Counterparts*, Springer, 2007, p. 92.

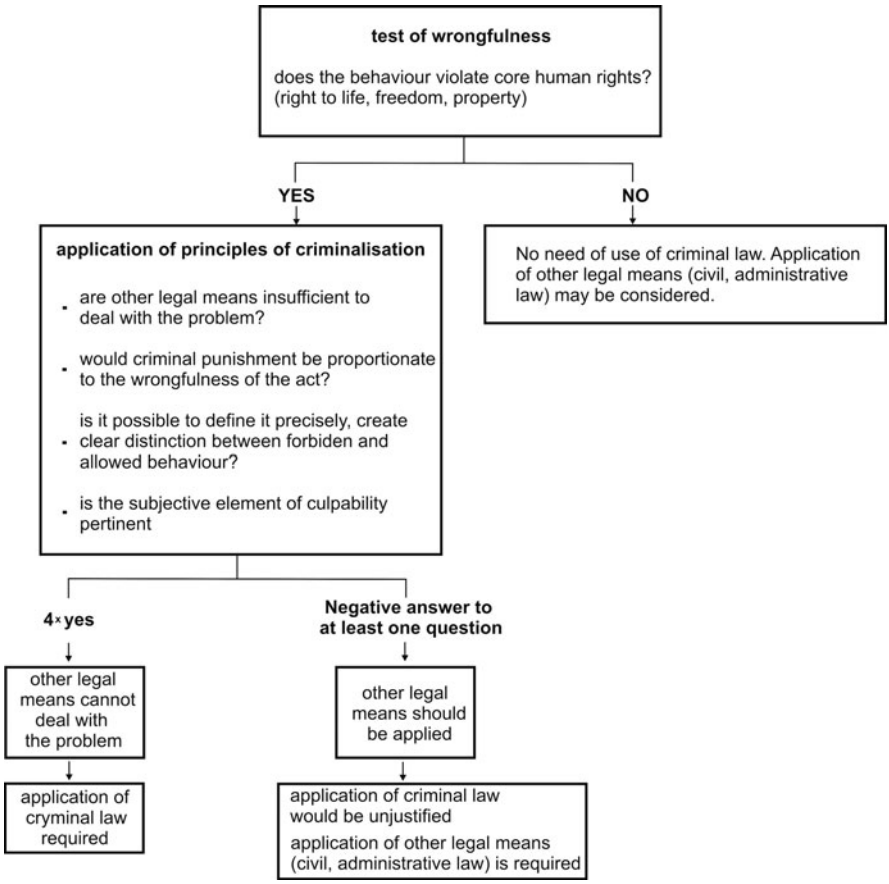

Fig. 3.3 Schema of two-step theory of criminalisation

are already problems with the fulfilment of the first step of the criminalisation procedure. Nonetheless, if one agrees with the opponents of insider dealing, the behaviour must be analysed according to the second step principles. Is it serious enough to apply criminal law or other legal means could sufficiently deal with the issue? Only a profound analysis of this subject would allow for the application of the notion of a "rational legislature" (understood as a one that choses the proper means for the assumed goals[346]) with a faith that it is really rational and not only as a *fictio legis* that helps analyse the provisions of acts.

[346] On rationality of legislature see, e.g. WRÓBLEWSKI, Jerzy, *Zasady tworzenia prawa*, Warsaw 1989, p. 45ff.

Chapter 4
Alternative Models of Regulation of Insider Dealing

The analysis of the characteristics of a properly conducted criminalisation demonstrates that it is not a simply task. First, one has to decide what the main reasons of application of criminal law are. Then, he should reconsider the notion of wrongfulness and the principles of criminalisation that ought to be respected in order to create a new criminal regulation. All these elements have to be applied to a social phenomenon that allegedly requires a legislative intervention.

Meanwhile, many new criminal statutes are being enacted. The lecture of at least part of them demonstrates that at their origin was a need of political action rather than a profound examination of what should be done in order to deal with unwanted behaviour in a given situation. In consequence, the large number of criminal provisions that regulate many different domains of human activity, including regulation of stock exchange markets, provoke an impression that criminal law is a natural and indispensable instrument to handle the arising irregularities.

Such a situation surprises. It seems to forget that the criminal law is not the only tool at the disposition of a legislature. Other branches of law also offer solutions that may be efficiently applied in order to tackle the undesirable situations. The list of possible alternatives for criminal law and means that may help reduce the phenomenon of overcriminalisation is quite intuitive and different authors refer to similar notions.[1] Thus, they include other branches of law, i.e. administrative or civil law, but also para- or extralegal tools like codes of good conduct as well as educational campaigns that increase the common knowledge about certain domains.

Of course each of these means has its own characteristics, principles, and objectives that should be observed. As in the case of criminal law, their violations would lead to creation of an act that would be formally properly enacted and, in consequence, binding, but that would impair the law understood as a tool of justice.

[1] E.g.: AYRES, Ian, BRAITHWAITE, John, *Responsive Regulation, Transcending the Deregulation Debate*, Oxford University Press, 1995, chapter 2, ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009.

I. Seredyńska, *Insider Dealing and Criminal Law*,
DOI 10.1007/978-3-642-22857-5_4,

In this chapter the applicability of criminal law to insider dealing prohibition will be analysed. It will be made on the basis of the two-step criminalisation technique presented in Chapter 3, that emphasises personal rights and principles of criminalisation. Then, the other applicable legal solutions will be examined. First, the administrative law is considered. The Market Abuse Directive imposes an obligation to introduce administrative sanctions that aim at the punishment of dealing insiders. The same Directive also allows introduction of criminal sanctions. However, a question may be asked on whether infliction of administrative sanctions would not be enough to deal with the issue.

The second possible solution that would help reduce the omnipresence of criminal law is the application of civil law in all the situations when a victim and a wrongdoer are identifiable. Insider dealing is a stock exchange market phenomenon. It is supposed to increase the benefits of some market players at the expense of other market players that make their deals unaware of the future probable changes in the value of securities. Meanwhile, civil law is dedicated to resolution of the conflicts between individuals. In light of the principle of subsidiarity, one may consider that it is the best and the least intrusive legal mean that allow forcing the insider to give back the undue profits and compensate the losses suffered by other market players. Application of the civil law in order to deal with the insider dealing should be understood twofold. First, the relation between an insider and the issuer should be analysed. In most cases there is a contractual link between them, i.e. an employment contract or another legal basis of cooperation. Thus, an issue of introduction of proper stipulations into the contract that would prevent use of inside information should be examined. Moreover, the victims of the inside deals should have an efficient means that would help them deprive the insider of the profit made at their expense. The common actions of the victims of insider dealing may be organised in the form of so-called "class actions". Their advantage is the limitation of the costs of legal counsel and bigger impact and publicity that may be achieved.

Finally, the "soft law" tools, such as codes of conduct should be considered. In spite of the visible distrust for the market participants, especially the bigger ones, application of this mean of control should not be left aside. Creating the internal rules that would guide the behaviour of the market participants on a given stock exchange markets could contribute to the creation of different financial centres where a different scope of protection would be applied. The market participants would then have a possibility to choose a market that suits them most and respects their values. Moreover, in the domain of the "soft law", or paralegal tools, a state's obligation to assure the proper education of the market participants should be mentioned. Although it does not solve the problem of appearing irregularities, it may help the small market players make better estimations and not be easily misled by populist claims, regardless of whether they are made by politicians or unfaithful market participants.

A Principles-Based Criminal law

Equipped with the tools provided by the principle-based theory of criminalisation, one may try to re-examine the issue of the insider dealing regulation and applicability of criminal law to deal with it.

First, a question may be asked whether a legislative intervention is necessary, i.e. whether it is indispensable for a good functioning of the market to regulate this behaviour. As it was demonstrated in Chapter 1, both economists and philosophers have various opinions. Some perceive insider dealing as intrinsically evil for the market as well as immoral and unfair in relation to other market participants and the whole economy/community. They underline the fact that insiders outperform the markets and deal with uninformed market players. The pressure in their analyses is put on a concern that, if on the market better-informed investors make some deals, it may discourage the small market players from dealing. Uninformed ones may simply fear being cheated. The other specialists do not agree with such an approach and see noting questionable in this kind of behaviour. They consider that neither of the elements of the insider dealing impairs competition or merits condemnation. In their opinion, perceived unfairness of this behaviour is based on an envy-based approach, i.e. the psychological resentment for those who are capable to make bigger profits. Moreover, there are analyses and opinions that demonstrate the beneficial influence of insider deals on functioning and the transfer on information on the stock exchange markets. According to them, deals made by insiders increase the flow of information on stock markets and make prices of the listed financial instruments more reflective. They also do not find any violation of the rights of the dealing market players.[2] In consequence, from the very beginning it is not easy to take the right decision. Nevertheless, if a need of undertaking an organised action is ascertained, it does not mean that the legislature should directly enact a new criminal rule. First, both steps of criminalisation procedure should be applied, i.e. verification of the level of wrongfulness of the act and application the principles of proper criminalisation. Finally, other than criminal legal means should also be taken into account.

I Wrongfulness

As it was demonstrated in Chapter 3, the process of criminalisation should begin with the analysis of the wrongfulness of a given phenomenon. A simply statement that a behaviour is unfair is not enough to apply criminal law. Thus, the first decision should refer to the core human rights that are allegedly violated by insider dealing. It may be easily observed that there is no violation of the right to live. Next,

[2] For more details see: Sect. B, Chap. 1.

the rights regarding freedom and private property should be examined. It may be said that insider dealing does not deprive anybody of the right to act freely on the market. Moreover, it does not oblige any market player to dispose of their property; the deals are made mostly on an anonymous market and for the prices established in advance by both parties to the agreements.

Nonetheless, the inequality of an insider and other market player cannot by forgotten: he knows more than the others. One could wonder how an insider could share his knowledge with his contractor. It seems practically impossible. Thus, in order to limit the inequality between investors and reduce the advantage that an insider has, more pressure should be put on disclosure obligations. But these obligations should be assigned to the issuers instead, and not to insiders. Full and clear disclosure of the important facts related to issuer could prevent the informational disparities between the contracting parties (at least in relation to the investors that are sufficiently attentive to learn the news about the issuer of the financial instruments they are dealing in). The disclosure may also prevent undertaking the decisions about acquisition or disposal of that are based on the fragmentary data and would likely be different if more information was available.

But it should be remembered that action of an insider (i.e. his deals) are not intentionally misleading anybody.[3] They are neither interfering with someone else's freedom, nor depriving of or infringing someone's property. In consequence, the analysis demonstrates that the process of criminalisation should be stopped at this moment. There are no premises on which the application of criminal law may be based. Otherwise, it would be an abuse of this branch of law. It does not mean that insider dealing cannot be regulated in any other way. On the contrary, the declaration that a given behaviour is not wrongful for the purposes of the criminal law does not exclude a possibility to apply other branches of law to deal with the issue. It should be just stated that some legal framework should shape the behaviour. The criminal law is not the only tool at the disposition of the legislature that may be applied.

II Principles of Criminalisation

However, if one accepts other theories of wrongfulness and considers that insider dealing is wrongful (e.g. it is immoral, or infringes the legally protected good of investors' confidence in the markets), it does not automatically mean that the act should be regulated with the help of the criminal law. There is still the second step of the criminalisation procedure that should be respected, i.e. application of the principles of criminalisation.

[3] Contrary to market manipulation that is intentionally sending a wrong message regarding the value of financial instruments or trends that are on the market. Compare: Market Abuse Directive, Article 1.2.

1 Principle of Subsidiarity

According to the principle of subsidiarity, criminal law may be applied only if other means would be ineffective to deal with an unwanted behaviour. Thus, an analysis should be conducted on whether the application of administrative or civil law solutions may efficiently solve the problem. The general assumptions on which are based these two branches of law will be presented below.[4]

Here, it should be noted that administrative law provides possibility to apply sanctions that may be quite burdensome and for many reasons similar to the criminal ones. At the same time they are not linked to social censure and condemnation for their addressee and, in consequence, they do not result in social costs similar to the infliction of criminal sanctions.

Meanwhile, civil law is applicable in all situations when the accent is put on a compensation of suffered losses. Thus, it is an efficient mean when the person of victim and the amount of suffered losses is clearly definable.

In case of the insider dealing regulation, use of one of these options depends on the understanding of the issue – whether the European (oriented on the fairness on the market), or American (concentrated on the theory of misappropriation) definition is accepted.[5] Nevertheless, this short presentation demonstrates that criminal law has here two strong competitors that may be found more useful and adequate. In practice it means that one should be extremely careful when still considering application of criminal law.

2 Principle of Proportionality

The next issue that has to be tackled in the procedure of criminalisation is a consideration of what are the least intrusive mean that may be applied in fight with insider dealing. It also means that one should examine the whole legal system and compare the sanctions and legal tools used to resolve the other social concerns. This is the only way to respect proportionality, not only between wrongful act and applied legal solution, but also between different legal regulations used to deal with various issues. The proposed solutions cannot be either too harsh or too lenient and must be consistent with general legal policy applied in a state. It should be again recalled that criminal law is not the only state's tool in fight against unwanted behaviours.

In this analysis, the degree of wrongfulness should be taken into account. One may found that there are behaviours which may be qualified as "intrinsically evil". Meanwhile there are others whose wrongfulness is more questionable. An opinion may be then defended that application of criminal law to the latter case could be

[4] See Sects. B and C in this chapter.

[5] For more details about European and American definition of insider dealing see Sect. A, Chap. 1.

contested as disproportional. As it has been already demonstrated at the first step of the criminalising procedure, the theory of wrongfulness based on protection of the basic human rights does not allow applying criminal law to deal with the issue of insider dealing. Other legal theories have to be applied to define its appropriateness for the application of criminal law. But it is not a convincing indication in favour of a new criminal statute.

3 Principle of Legality

It should not be forgotten that the creation of a criminal rule requires a maximal respect for the principle of legality. Hopefully, it may be assumed that in democratic societies the rules of the proper enactment of legal acts are respected. That means that the rules of procedure are fulfilled, the acts are published and penalties are applied only to breaches committed after the legal acts entered into force.

Meanwhile, there is still one requirement of the principle of legality that may provoke some doubts: *nullum crimen sine lege certa*. Clear formulation of a rule is indispensable for distinguishing between forbidden and allowed behaviour. If properly made, there are no doubts, like in case of the rule stating that "*who kills a man, should be punished [. . .]*".[6] Although it is short, its content may be precisely described and applied in practice.

In case of insider dealing, one has to define a complicated conduct. Moreover, it is a behaviour that becomes wrongful only under a special circumstance of informational disparities between a dealing insider and other market participants. Thus, the conduct as well as the circumstances should be precisely described. The definition that can be found in the Market Abuse Directive, as it was presented above, contains some general notions that are ambiguous.[7] It should be underlined that it was coined for the purposes of administrative law. The states that decide to apply criminal law to prosecute insider dealing should define the elements of the prohibition as clearly as it is possible. Otherwise, there may be doubts on when the insiders' behaviour violates the rules and when it is still permissible.

The doubts arising from the issue of the proper formulation may be illustrated through a simple example. Let us suppose that, in relation to given financial instruments, inside information may be positive, i.e. it leads to increase of their value or negative, i.e. it leads to decrease of their value. Mr. Smith enters into possession of this inside information relating to these financial instruments. Excluding more advanced operations (like buying options that would let him make profits in case of drop in value of the financial instruments) one may decide to undertake rational decisions on a basis of this information. The kind of the decision would

[6] Polish Act of Parliament of 6 June 1997 - Criminal Code, Article 148 paragraph 1.

[7] For more details see section "Constitutive Elements", Chap. 1.

Table 1 Possible decisions of an insider

Mr. Smith	Not interested in financial instruments	Wants to buy	Wants to sell	Wants to keep
Positive inside information	Buys	Buys	Don't sell (i.e. does nothing)	Keeps (i.e. does nothing)
Negative inside information	Does nothing	Renounces to purchase (i.e. does nothing)	Sells	Sells

depend on his situation at the moment of learning the information. The possible decisions are presented in Table 1.

It may be observed that all actions undertaken by Mr. Smith are based on inside information. Thus, the insider dealing prohibition should be applied to all of them. Meanwhile, only in a case of active behaviour they may be prosecuted and punished on a basis of binding regulations. As long as Mr. Smith does nothing (e.g. by renouncing his planned actions), his actions are undetectable by the supervising authorities or prosecutors and cannot be punished. From this example, at least two conclusions may be drawn. The first refers to the discussion on the influence of insider dealing regulation for the markets. Visibly, the regulations encourage the insiders not to undertake any actions.[8] Secondly, what is more important for the principle of legality is that not all actions covered by the insider dealing prohibition are punishable. It should be discussed then whether the formulation of the rule should not be changed in order to prevent such disparities between the actual and theoretical scopes of prohibition. Maybe the scope of the forbidden behaviours should be limited in their description? It is clear that the existence of such disparities is not proper.

4 Principle of Culpability

The properly built criminal rule must provide a subjective element of culpability. Otherwise, the criminal law would not concentrate on the person of the wrongdoer but be only an "accountant" that mechanically verifies fulfilment of elements of offences. It means that if a decision about criminalisation of insider dealing had been taken, the rule should have been formed properly. The wording of the insider dealing act according to the Market Abuse Directive provides only objective criteria for violation of the rule. In order to breach the prohibition, one has to be only "in possession" of inside information while he deals.[9] This objective element

[8] Similar conclusion presents Doug BANDOW in: *It's Time to Legalize Insider Trading*, published on www.forbes.com on 20 January 2011 (last visited on 22 January 2011).

[9] Market Abuse Directive, Article 2.1.

arises from the interpretation of the insider dealing definition according to the Insider Dealing Directive[10] and the current Directive, and was confirmed by the CJEU case-law.[11] Again, as in the case of the proper formulation of the rule, it requires that a legislature that decides to apply criminal law to insider dealing should not simply transpose the Directive's definition to its legal order. Otherwise, it risks creating an incomplete legal rule.

5 *In dubio pro libertate*

The final stage of the criminalising procedure sums up all the responses given during the examination of the principles of criminalisation. In such a way, one may reconsider the necessity of applying criminal law. As it was presented, two of the principles, subsidiarity and proportionality, demonstrate that legal means rather different than criminal law should be applied. Meanwhile, the principle of legality and the principle of culpability underline the concerns that arise from a simple transposition of the Market Abuse Directive definitions in to national criminal statutes.

If one starts to have doubts regarding the foundation of the existence of the prohibition of insider dealing based on the criminal law authority but still is unsure whether this behaviour may be unregulated, one should try to analyse the other applicable options. Administrative and civil laws also provide opportunities to impose penalties on an individual that would deprive him of advantages he has taken (if the opinion that he should not have taken them prevails).

III Decriminalisation

When many doubts concerning the appropriateness of the criminal insider dealing regulation arise, one may wonder what should be done with already-existing criminal rules. According to some authors, decriminalisation is impossible in the current market situation because it would send a wrong message to market participants.[12] This opinion cannot be accepted. Of course, the best solution is to enact new criminal regulations prudently, with maximal respect for the principles of criminalisation. That would help to avoid situations when unnecessary legal

[10] Insider Dealing Directive, Article 2.1, for more details see section "Forbidden Practices", Chap. 1.

[11] CJEU, 23 December 2009, *Spector Photo Group and Van Raemdonck*, C-45/08, CONAC, Pierre-Henri, *La Cour de justice facilite la répression des opérations d'initiés en établissant une présomption réfragable d'utilisation indue de l'information privilégiée*, Revue des sociétés, Juillet-Août 2010, pp. 325–331.

[12] CHAPUT, Yves, *La pénalisation du droit des affaires: vrai constat et fausses rumeur*, Pouvoirs, 2001/1, No. 128, p. 100.

provisions could be found in the national legal system. When, nevertheless, the improper legal rule was enacted, the respect for the law and for the members of community requires that it should be repealed and replaced by a new act (if still a legal intervention is necessary). The legislature should not give permission for the existence of the rules that violate the principles on which the legal order is based, even if it means to "plead guilty" and admit that a mistake had been made.

B Administrative Law

I Applicability of Administrative Sanctions

Administrative law is applied to the domains where public order should be maintained or public interest requires it.[13] The issue of the proper definition of the notions of public order and public interests may provoke, however, some difficulties. One must establish first a proper balance between an ultra-liberal attitude that requires maximal limitation on the state's powers and socialistic theory that claims the necessity of the governmental or administrative omnipresence. In a democratic society the most justified seems to be reference to the principle of subsidiarity. As long as the members of a community are able to deal with the different issues, there is no need for a state's intervention. When, however, managing a given domain is too complicated or burdensome, the legislature may and should intervene.

In the spheres that are regulated or controlled by administrative law, the non-fulfilment of the administrative requirements leads to a special punishment. The notion of administrative sanctions means the penalties, repressive in their nature, that are imposed by an administrative body.[14] Traditionally, administrative law sanctions were applied to the persons who work for the administration.[15] Nowadays, their scope of application covers all entities that are supervised or controlled by the administrative authorities.[16] This increase in the range of the administrative sanctions arises from the fact that the last decades brought the raise of the state's intervention into various spheres of the citizens' activity.[17] One of the aspects of

[13] DUPUIS, Georges, GUÉDON, Marie-José, CHRÉTIEN, Patrice, *Droit administratif*, 10th edition, Dalloz, 2007, p. 3.

[14] DUPUIS, Georges, GUÉDON, Marie-José, CHRÉTIEN, Patrice, *Droit administratif*, 10th edition, Dalloz, 2007, p. 498.

[15] ROSENFELD, Emmanuel, VEIL, Jean, *Sanctions administratives, sanctions pénales*, Pouvoirs 2009/1, no. 123, p. 61.

[16] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 201.

[17] QUASTANA, Jacques, *La sanction administrative est-elle encore une décision de l'administration?,* L'Actualité Juridique Droit Administratif, Special issue, 20 October 2001, p. 143.

this development is the creation of the independent administrative authorities that control and supervise specific domains. Speaking about their independence is not fully justified. They are just another emanation of the state's powers (instead of traditional Ministries). But it must be admitted that their specialisation helps them tackle the concrete issues emerging in the domains of their interests. The profound knowledge of the domain and professional personnel make them more apt to properly deal with their tasks and fulfil their duties more efficiently than using traditional tools.

Initially the doubts about possibility to apply administrative sanction to persons that are neither working for the administration nor are contractually linked to it were presented.[18] It should be observed that the sanctioning activity of the administrative authorities negates the principle of the separation of powers. According to it, only an independent judge is allowed to impose penalties on an individual.[19] Meanwhile, the administrative authorities enact the rules and prosecute for non-compliance with them.[20] The development of administrative sanctions in many states demonstrates that this obstacle had been overcome. An example of the reasoning that led to permission for application of this kind of sanctions can be found in the decisions of the French Constitutional Council.[21] Making a reference to the principle of the separation of the powers as well as to the principles of the criminal law and basic principles of law, it stated that infliction of administrative sanctions does not violate these principles if only the administrative body acts within its competences, attributed by the law (i.e. properly enacted by the legislative body). However, it underlined that imposition of any penalties that have punitive character should respect the principles relating to criminal punishment and basic principles of law. The subsequent decisions precised that this requirement involved the obligation for administrative authorities to respect the principle of legality, the principle of non-retroactivity of the more severe penalties, the principle of proportionality and the right to judicial review of the decision as well as right to defend oneself in the proceeding.[22] In consequence, it should be remembered that the administrative courts (or sentencing bodies) are not free in their activity. The French Constitutional Council followed the path determined by the ECHR

[18] QUASTANA, Jacques, *La sanction administrative est-elle encore une décision de l'administration?*, L'Actualité Juridique Droit Administratif, Special issue, 20 October 2001, p. 142.

[19] DUPUIS, Georges, GUÉDON, Marie-José, CHRÉTIEN, Patrice, *Droit administratif*, 2007, 10th edition, Dalloz, p. 499.

[20] ROSENFELD, Emmanuel, VEIL, Jean, *Sanctions administratives, sanctions pénales*, Pouvoirs 2009/1, No. 123, p. 62.

[21] Decision of the Conseil Constitutionnel of 17 January 1989, Official Journal of 18 January 1989, Revue Française de droit administratif 1989.215, Decision of the Conseil Constitutionnel of 28 July 1989, Official Journal of 1 August 1989, Revue Française de droit administratif 1989.671.

[22] DUPUIS, Georges, GUÉDON, Marie-José, CHRÉTIEN, Patrice, *Droit administratif*, 10th edition, Dalloz, 2007, p. 499.

case-law[23] that obliged the administrative bodies to respect the principles that protect the addressee of their decision and do not allow to render decisions negligently. It means that administrative proceedings should respect the safeguards that the Convention for the Protection of Human Rights and Fundamental Freedoms sets out for persons accused in criminal proceedings. It includes, e.g. the presumption of innocence, the right to full notice of charge, sufficient time to prepare defence, the right to an interpreter or legal assistance. It is so even if Article 6 of the Convention relates to the courts and courts and in administrative proceeding the decision is issued by an administrative body.

The sanctions that are imposed by the administrative authorities differ from those imposed by the criminal courts. The penalty of imprisonment is not applied; the intentionality of the act is not analysed. There is just a statement that a rule was violated.[24] Applied sanctions may be of a different character. In relation to financial markets, very often, financial sanctions are applied. In relation to the entities that for performance of their activities require administrative permission, licence etc., the punishment may consist in the withdrawal of such permission. It is also important that the administrative penalty can be applied both towards individuals and legal entities. It is a simple consequence of the lack of the personal guilt requirement. The individual attitude towards the concrete breach is not relevant to the imposition of a penalty. Thus, it may be also stated that a given rule was violated by a legal entity without further examination on who in fact did it and whether it was intentionally. It is also important that, contrary to criminal law punishment, the administrative penalty does not entail the moral condemnation by the other market participant of its addressee. Of course, it may reduce his trustworthiness, but is not linked to imminent ostracism by the other members of the community. On the other hand, the pecuniary character of the administrative penalties makes it similar to the pecuniary criminal sanctions. For that reasons many authors either call them "administrative-criminal" sanctions[25] or challenge the existence of the distinction between criminal and administrative sanctions.[26] Administrative sanctions are often presented as an interesting alternative to the application of criminal law.[27] From the principles-oriented point of view, one cannot consider administrative sanctions as a substitute for the criminal ones.

[23] *Öztürk v. Germany*, judgment of 21 February 1984, Series A no. 73, *Schmautzer v. Austria*, judgment of 23 October 1995, Series A No 328A.

[24] ROSENFELD, Emmanuel, VEIL, Jean, *Sanctions administratives, sanctions pénales*, Pouvoirs 2009/1, No. 123, p. 63.

[25] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 204ff, SZUMIŁO – KULCZYCKA, Dobrosława, *Prawo administracyjno – karne, czy nowa dziedzina prawa?*, Państwo i Prawo, 2004, No. 3, pp. 3–16.

[26] DOBKINE, Michel, *L'ordre répressif administratif,* Recueil Dalloz, 1993, Chronique, p. 157, in : ROSENFELD, Emmanuel, VEIL, Jean, *Sanctions administratives, sanctions pénales*, Pouvoirs 2009/1, No. 123, p. 64.

[27] QUASTANA, Jacques, *La sanction administrative est-elle encore une décision de l'administration?,* L'Actualité Juridique Droit Administratif, Special issue, 20 October 2001, p. 142.

Simply, criminal sanctions may and should be applied only if properly-used principles of criminalisation indicate so. And administrative penalties should be inflicted when criminal law cannot be used but the protection of the social order requires application of the sanctions backed by the state's authority. In consequence, it is not a simple issue of an alternative solution, but each branch of law has its objectives and scope of applicability.

For the same reasons, inacceptable is the opinion of authors who claim that the criminal procedure and judgment rendered by a criminal court are more in favour of an accused person because all the principles of proper sentencing (such as *in dubio pro reo*) have to be observed.[28] First of all, if the principles of proper sentencing established by the ECHR are respected, there is not a big difference between procedural safeguards in administrative and criminal proceedings. However, more important is the fact that the choice of the path, whether it be criminal or administrative, should not be made on a basis of any other consideration than a kind of the wrongful act. Thus, the use of administrative sanctions is the only solution when the order or proper functioning of a given domain of human activity is violated but the act does not interferes with the basic rights of any other individual.

Finally, an argument against administrative sanctions as an alternative for criminal prosecution and sentencing may be heard that they do not compensate the victims of wrongdoing.[29] Such an approach is quite surprising. Criminal sanctions do not aim at the compensation of the victims, either. Even if a criminal court states about compensation of victims, this part of its judgment may be qualified as a "civil law judgment". Thus, there is no real difference that acts in favour of criminal law regulations.

II Procedural Safeguards

One might wonder what conditions should be fulfilled in order to impose administrative sanctions without violation of the rights of their addressee. The principle of legality requires that both the rule and the sanction threatening for its violation should be enacted before the sanctioned behaviour took place. Moreover, the enactment should be made by the parliament and not by an administrative authority. It seems necessary that the infliction of any kind of penalties should have a democratic basis and should arise from the will of the nation's representatives.

Secondly, should be excluded from the proceeding any employee of the administrative body that is in any way related to the decision's addressee. It may be not

[28] ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, p. 204ff.

[29] *La dépénalisation de la vie des affaires*, Rapport au garde des Sceaux, ministre de la Justice, elaborated by a working group chaired by Jean-Marie Coulon, January 2008, p. 29.

only a direct familial link but also any relation (official, personal) that might interfere with a duty to fulfil the obligations impartially.

During the administrative proceeding that leads to imposition of a penalty, the alleged violator of the rule should have right to present his statement and to defend himself against the administrative body's allegations.

Moreover, the decision should be always well justified. The justifications should include not only the presentation of all evidence gathered by the administrative body but also on which elements it based its decision, what was considered to be proved and which pieces of evidence in the opinion of the administrative body cannot be trusted and for what reason. Moreover, the justifications should present the legal basis of the decision.[30]

Another crucial element is the possibility of a judicial review of the decision. It assures the possibility to review the premises on which the decision was based as well as the way the evidence was evaluated.

Finally it should be underlined that the principle of proportionality should also be applied in relation to the administrative law. That means that the penalty should not be too harsh and that it should comply with the seriousness of the breach. Meanwhile, as it was presented in Chapter 2, in some jurisdictions the administrative penalties that may be inflicted for a violation of the insider dealing prohibition do not provide a maximal amount. Such a rule seems to create a very dangerous situation of unlimited powers of an administrative body. Even if some internal guidelines and rules are applied, they do not have the power and force of an act of parliament.[31] Hence, if application of administrative law to deal with the issue is considered, creation of proportionate administrative rules that provide the maximal amount of penalty that may inflicted is one of the prerequisites. It may be hoped that the activity of the newly created ESMA will help to create such common minimal procedural safeguards. It would be a fulfilment of its obligation to contribute to the establishment of high-quality common regulatory and supervisory standards and practices.[32]

III Parallel Application of Criminal and Administrative Sanctions

Application of both criminal and administrative sanctions towards one act seems to be unacceptable. First of all, it arises from the interpretation of the "criminal case"

[30] Compare, e.g. with Polish Act of Parliament of 14 June 1960 - Code of the Administrative Procedure, Article 107, paragraph 3.

[31] See, e.g. the FSA Handbook presentation in section "Administrative Sanctions", Chap. 2.

[32] Article 8.1(a), Regulation No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, pp. 84–119.

proposed by the ECHR, which extended the necessity of assuring in administrative proceedings the same procedural safeguards as in criminal ones. Thus, it would be unclear why, in spite of similar principles, the *ne bis in idem* principle could not be applied and would be limited only to criminal cases *sensu stricto*.

The second argument refers to the foundations of the legal theory. As it was presented in Chapter 3, the criminal law should be distinguished by its objectives: restoration of justice and imposition of proper punishment on one who, by his act, has violated the equality between the members of the community. Moreover, the violation infringed the basic human rights that every person should enjoy. Meanwhile, administrative law and sanctions are applied when one violates the rules of the organisation of a given domain of human activity; the rules that aim at a better functioning and improvement of the performance. Therefore, the two systems have different goals. Their mutual application means that the legislature cannot decide what the objectives of a new regulation are. The concern is not solved by taking into account in one proceeding the sanctions imposed in another, as it was made in France after the decision of the Constitutional Council.[33] In spite of the fact that penalties may be similar, the principles that create basis for their imposition in each proceeding are incomparable and they cannot be simply deducted from each another without violating the foundations of both proceedings.

C Civil Law

Civil law tools are used when a dispute between two equal parties needs to be resolved. As it was already said, the most important feature of the civil law is that it aims at compensation of the suffered losses.[34] Thus, a question may be asked on who has suffered losses caused by this type of behaviour. In case of application of civil law, it is not enough to state that the whole market suffered or the trust in the markets has been impaired. These notions cannot be evaluated for the purposes of calculation of a proper compensation. In consequence, more concrete objects of protection and more tangible damages should be found.

There are at least two possible ways the civil law may be applied in order to deal with the issues arising from the insider dealing regulation. Their application allows for decriminalisation of a conduct and introduction of the affordable civil law mechanism.[35]

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[33] Decision of the Constitutional Council of 28 July 1989, No. 89-260 DC, Official Journal of 1 August 1989, Revue Française de droit administratif 1989.671, see also: Section "Coexistence of Criminal and Administrative Sanctions", Chap. 2.

[34] See, among others: ŻÓŁTEK, Sławomir, *Prawo karne gospodarcze w aspekcie zasady subsydiarności*, Wolter Kluwer Polska, Warsaw, 2009, pp. 197–201.

[35] Similarly: COULON, Jean-Marie, *Les nouveaux champs de pénalisation, excès et lacunes,* Pouvoirs 2009/1, No. 128, p. 11.

First of all, it may be stated that the party that suffers the most because of the inside deals is the employer of the insider, i.e. the company where the information was created and, most often, to which it relates. Thus, the issuer ought to try to discourage its insiders from disclosing any important data before it decides to do so. A corporation that wants to keep information secret should use means of protection already existing in civil law such as a trade secret, or oblige contractually its employees from disclosing or trading on its basis.[36]

The second tool of civil law that may be applied towards insider dealing is launching a lawsuit against the insiders by other market players that suffered losses because of the inside deals. If, of course, a relation between the deals of an insider and losses of other market players may be established. In order to encourage those market players who consider that the suffered losses are not sufficiently high to launch a lawsuit and bear its costs, the mechanism of collective redress, or class actions should be proposed.

I Contractual Liability

Supposing that economic analyses demonstrating that insider's deals divulge the information before it was publicly announced by the company are correct, the employees that make deals based on such information act against their own employers. They inform the market (even if indirectly) about some possible consequences that information may have for the issuer's performance. In consequence, if an issuer wants to keep this kind of information confidential, it should prohibit, through the employment contract, undertaking of such transactions. Moreover, in some companies oriented on financial services for market participants and professional intermediaries on the stock exchanges, engaging into insider dealing may impair the proper fulfilment of the employees' duties. For instance, broker-dealers may be too concentrated on trying to make additional profit on the basis of received information on their own rather than focus on the best interests of the clients.[37] It may lead to delays in the realisation of the clients' orders and, in consequence, to the loss of the client's confidence and smaller revenues. In order to avoid such a situation, a special clause should be included into the employment or management contract. An employee would engage himself not to make a personal profit on a basis of the information gained during the execution of the professional duties. In case of its violation, the employer would be entitled to launch a civil lawsuit against a person who did not obey the contractual duty or apply any other provide by the agreement sanction. Such a regulation would in fact

[36] ENGLE, Eric, *Insider Trading: Incoherent in Theory, Inefficient in Practice*, Oklahoma City Law Review, 2006, vol. 31, p. 504.

[37] Information received during a conversation with a vice-president of one of the leading Polish broker-dealers' offices.

be similar to the one existing in the United States of America, where the insider dealing prohibition is based on violation of the fiduciaries duties toward the employer.[38] But it would not need use of the administrative or criminal legal tools and would simply were settled between the interested parties.

II Individual Redress and Class Actions

Another possible application of civil law may take form of direct lawsuits brought by other market players against the insiders that made deals on their expense. They could demand the compensation of the losses they suffered. In cases when the suffered losses are not high or too many concerned persons are involved, a reference should be made to class actions. Class actions are civil lawsuits launched collectively by persons that suffered losses in a single occurring.[39] Their main advantage over traditional lawsuits that are brought to a court by individuals is that they are cheaper for the participants and may unify and accelerate the compensation of suffered losses. Class actions have been used in the United States of America as well as in many European states.[40] Moreover, they are still being introduced into the legal orders of the states that had not known this concept.[41]

"*The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights*."[42] Class actions may be especially used in consumer cases. The notion of a consumer is usually understood as a person who acts outside the scope of his trade, business or profession.[43] It means that he or she does not have the sufficient knowledge about a given issue and must rely on advices given by specialists or decides on his own basing on widely available information. It may be observed that there are some factors common to a consumer and a non-professional market player. The latter uses the stock exchange as an additional tool to increase his welfare but this activity lies beside his professional or business activity. Moreover, usually he or she has only limited knowledge about the functioning of the market and relies on widely available information. It seems that, as in the case of violation of the obligation towards the consumers, the class action

[38] See Sect. A.II, Chap. 1.

[39] SIERADZKA, Małgorzata, *Ustawa o dochodzeniu roszczeń w postępowaniu grupowym*, Oficyna, 2010, available through Lex.

[40] E.g. in Denmark, Spain, Sweden, Germany or the United Kingdom, see: SIERADZKA, Małgorzata, *Ustawa o dochodzeniu roszczeń w postępowaniu grupowym*, Oficyna, 2010, available through Lex.

[41] E.g. they were introduced to the Polish legal order by the Act of Parliament of 17 December 2009 on class actions *(Ustawa z 17 grudnia 2009 r. o dochodzeniu roszczeń w postępowaniu grupowym)* published in Dz.U. 2010, No. 7, item 44.

[42] *Mace v. Van Ru Credit Corp.*, 109 F. 3d 338 - Court of Appeals, 7th Circuit 1997.

[43] E.g. Directive 87/102 Article 1(2)(a), Directive 2000/31 Article 2(e), Directive 2005/29 Article 2(a).

as a tool of civil law may serve as a way to compensate the losses suffered by the market players through insider deals.

It should be observed that the popularity of class actions in the United States of America arises from the fact that a court may decide in this kind of proceeding about imposing punitive damages. Their objective is to punish the violator of a rule and they may importantly overrun the actual damage suffered by the plaintiffs. This and the fact that lawyers' pay may be conditional and depend on the result of the lawsuit result in a number of legal practices that observe the market and if only they notice any abnormal change in value of the securities they look for any shareholders interested in launching a lawsuit. A single interested person is enough to launch a class action, because the American system is based on an opt-out basis: in order not to be covered by the class action one has to expressly declare that he does not want to participate in it.[44] Thus, the holders of the financial papers are not obliged even to observe the market. The lawyers do it for them.[45] This system inevitably leads to some abuses but demonstrates an alternative for existence of a governmental control. However, its introduction would require a violation of the basic principle of the civil law, i.e. the compensation and not enrichment through a civil lawsuit.

But even basing on a traditional understanding of the civil law, i.e. sentencing of the damages that do not exceed the *damnum emergens* and *lucrum cessans,* class actions may serve as a useful tool for small market players that want to recover the suffered losses but are not motivated enough to bring an independent lawsuit. Class actions permit sharing the cost of judicial proceeding as well as the legal counsellor fees. Besides, they allow for a single evidence hearing instead of numerous hearings that would be inevitably if each participant acted independently. It should be also observed that a class action may more easily than an individual lawsuit gain some publicity. An individual lawsuit, where the claimant wants to recover a small compensation of damages may be unnoticed by markets and does not have any impact on the public image of the sued insider. Meanwhile, a big class action of victims who demand the damages for their losses is more susceptible to attract public attention and influence the way the issuer is perceived. Thus, the issuers would be more willing to avoid the situations when their name would be presented in a bad context. Finally, class actions are also beneficial for the judicial system as a whole because they help to render consistent the verdicts issued on a basis of a given situation and reduce the number of the cases that are brought to courts.[46]

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[44] MATTIL, Peter, DESOUTTER, Vanessa, *Class action in Europe: comparative law and EC law considerations*, Butterworths Journal of International Banking and Financial Law, October 2008, p. 484.

[45] ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, pp. 22–24, available through: www.ecgi.org/wp.

[46] Justification of the governmental project of the Polish law on class actions, available at: http://orka.sejm.gov.pl/Druki6ka.nsf/0/0E73993108750163C125758A004227CB/$file/1829.pdf (last seen on 12 January 2011), p. 3.

It should be noticed that there are many differences between the class action systems that exist in different Member States. They concern the scope of the cases to which this kind of proceeding may be applied (e.g. in Germany, group actions are applied for the specific area of the financial markets activity while in Spain class actions regulation is not applied to losses arising from securities), there are various bodies that are entitled to launch a class action, etc.[47] That may make the restitution of damages in insider dealing cases more difficult, especially given that in many cases, investors from different countries may be concerned. Therefore, it should be reconsidered whether there is no need for the European Commission to take an action similar to the one taken for the consumer law and ponder on a possibility to apply envisaged collective redress not only to consumer protection but also for protection of the market players against insider dealing.[48]

D No Regulation or "Soft" Law: Corporate Governance and Codes of Conduct

Creation of a criminal rule is justified only when the basic human rights are violated. Administrative rules govern different domains and aim at the establishment of an order. Both branches of law require the state's intervention to execute them. Application of civil law tools helps to solve the arising problems on a lower level – by reference to independent courts. Nevertheless, the principle of subsidiarity requires an analysis on whether state's intervention is needed at all and whether market participants are not capable to deal with the issues on their own. They may refer to the contractual rules applied voluntarily and created by the market participants themselves.

[47] For more details see: MATTIL, Peter, DESOUTTER, Vanessa, *Class action in Europe: comparative law and EC law considerations*, Butterworths Journal of International Banking and Financial Law, October 2008, pp. 484–488.

[48] For more about the collective redress in domain of consumer protection see: Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: EU Consumer Policy strategy 2007-2013. Empowering consumers, enhancing their welfare, effectively protecting them of 13 March 2007, available at http://ec.europa.eu/consumers/overview/cons_policy/doc/EN_99.pdf (last seen on 12 January 2011), Green Paper On Consumer Collective Redress (presented by the Commission), Brussels, 27 November 2008, COM(2008) 794 final, available at: http://ec.europa.eu/consumers/redress_cons/greenpaper_en.pdf (last seen on 19 February 2011). It should be noted that in its recent document, in question 33, a possibility of application of class actions to other areas of European Union law besides competition and consumer protection was tackled. (Commission Staff Working Document Public Consultation: Towards a Coherent European Approach to Collective Redress, Brussels, 4 February 2011, SEC(2011) 173 final, p. 12 (last seen on 19 February 2011)). Moreover, as it was mentioned above, the notion of consumer may also be applied to non-professional market players. Such an approach would extend the application of the consumer-oriented rules.

Moreover, the state may influence and shape the citizens' behaviours through educational and informational campaigns. Although the efficacy of such activity cannot be easily measured, it is obvious that more educated and conscious members of the society would support more easily the non-populist changes in law.

I Corporate Governance, Codes of Conduct

Beyond the tools remaining at state's discretion, there are still the means that help organise the market, influence its performance, and, in consequence, improve the whole national economy. From an economic point of view, corporate governance is the set of rules that determine how the economic surplus generated by an enterprise should be distributed among its shareholders or stakeholders.[49]

The origins of the corporate governance practices emerge from the fact that, broadly speaking, modern companies are owned by shareholders but control and management are outside their scope of powers and entrusted to professionals: managers and members of the board of directors.[50] Thus, introduction of some rules of conduct is necessary in order to ensure that the interests of those who engaged their savings into the company are well protected. Similarly, in the case of the companies that are hold by controlling and minority shareholders, the rights of the latter ones should be protected in order to assure that the controlling entity is not entering into transactions that are maybe profitable for its governance but are detrimental to a small investor.[51]

Competitiveness of the markets plays an important role in the economic developments. Uncompetitive ones do not attract investors, which leads to insufficient fundraising. Although corporate governance does not have its origins in the governmental institutions and arises from the market participants, it still has a big influence on the economy *sensu largo*. The economic researches demonstrate that the quality of the corporate governance is an important element of the competitiveness. Poor level of corporate governance and, in consequence, weak investor protection results in less competitive economies.[52] Thus, the governmental incentives to develop the corporate governance rule on the stock exchanges may

[49] ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 36, available through: www.ecgi.org/wp.

[50] It was observed already in 1932 by Adolf A. BERLE and Gardiner C. MEANS in: *The Modern Corporation and Private Property, Transaction Publishers*, New Brunswick, New Jersey, 2009.

[51] BAUMS, Theodor, SCOTT, Kenneth E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, The American Journal of Comparative Law, Winter 2005, Vol. 53, No. 1, p. 40.

[52] FULGHIERI, Paolo, SUOMINEN, Matti J., *Does Bad Corporate Governance Lead to too Little Competition? Corporate Governance, Capital Structure, and Industry Concentration,* (March 2005). ; EFA 2005 Moscow Meetings Paper. Available at SSRN: http://ssrn.com/abstract=675664, FULGHIERI, Paolo, SUOMINEN, Matti J., *Corporate Governance, Finance,*

influence the whole market and improve the economic results on the national level. Creation of the own compliance rules by the stock exchanges would boost their competitiveness and lead to increased responsiveness to investors' needs.[53]

Development of the corporate governance rules is made in order to improve economic efficiency and enhance the investors' confidence.[54] "*Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring*."[55] Nevertheless, it should be remembered that the creation of the rules of conduct that would guide a company's behaviours should not take into account only its direct shareholders. The company makes part of a bigger social network and enters into various relations with the different market participants who are, because of the various reasons, interested in its proper functioning. Among these "interested persons" or stakeholders, many different groups may be found, e.g. employees, suppliers, customers and shareholders.[56] The proper functioning of a company requires that its whole environment should be well balanced. This imposes a certain level of thinking that is not only concentrated on maximisation of the shareholders' benefits but, without naturally forgetting about the justified expectations of those who invested into the company, on activity that would by satisfying for all participant of its social network. It practice, that means that the corporations and their managers should not violate the legitimate rights of others to determine their own future and they are responsible for the effects of their actions to others.[57] Such a stakeholders-oriented style of corporate governance may be found in Germany and the states influenced by its system. Meanwhile, the states oriented on the Anglo-Saxon school of management are more shareholders-oriented.[58] Thus, the Germanic type of corporate governance should be more popularised and recommended.

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and the Real Sector, Working Paper, version of 18 May 2010. Available at: http://public.kenan-flagler.unc.edu/faculty/fulghiep/, p. 34.

[53] MAHONEY, Paul G., *The Exchange as Regulator,* Virginia Law Review, 1997, Vol. 83, No. 7, p. 1454.

[54] OECD Principles of Corporate Governance, 2004, p. 11.

[55] OECD Principles of Corporate Governance, 2004, p. 11.

[56] EVAN, William M., FREEMAN, R. Edward, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, in: MOON, Jeremy, ORLITZKY, Marc, WHELAN, Glen (eds.), Corporate Governance and Business Ethics, An Elgar Research Collection, Cheltenham, UK, Northampton, MA, USA 2010, p. 135.

[57] EVAN, William M., FREEMAN, R. Edward, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, in: MOON, Jeremy, ORLITZKY, Marc, WHELAN, Glen (eds.), Corporate Governance and Business Ethics, An Elgar Research Collection, Cheltenham, UK, Northampton, MA, USA 2010, p. 138.

[58] RHODES, Martin, van APELDOOM, Bastiaan, *Capital unbound? The transformation of European corporate governance*, in: MOON, Jeremy, ORLITZKY, Marc, WHELAN, Glen (eds.), Corporate Governance and Business Ethics, An Elgar Research Collection, Cheltenham, UK, Northampton, MA, USA 2010, pp. 316–337.

The important advantage of the soft law regulations is that they are flexible over time. In consequence, they may easily answer the needs of the relevant market. Moreover, in case of the self-regulation, the regulators use their deep knowledge of the given domain to create the rules.[59] Thus, they may be more just than the rules created on governmental level, where the knowledge about the issue is always received through intermediaries (who may also lobby in their favour).

The rules of compliance may be also based on an opt-out basis.[60] In such a way, listed issuers would decide whether they want to respect the anti-insider dealing regulation. Noncompliance would send a message to the market but would reduce the obligations of the enterprise linked with creation of special internal department that would survey the insiders and assure the proper realisation of the rules.

Creation and development of the corporate governance rules should not mean creation of the long codes of conduct that would attempt to replace the traditional acts of parliament. Researches demonstrate that, in this domain, less is more. Few reasonable rules may be more beneficial and better fulfil their goals.[61]

Stock exchanges have big incentives to make sure that conducted transactions comply with the standards of transparency. Only on such exchanges are the investors willing to invest their money. And a big trading volume is a prerequisite for stock exchanges existence.[62]

Disapproval for a given sort of market activity may be also expressed by the prohibition of such behaviour in the binding on stock exchanges codes of conducts. They regulate the proper practices that should be respected while undertaking activity on the financial markets. If an opinion that insider dealing impedes the fairness of the stock exchange transactions is accepted, markets where this kind of behaviour can be found do not attract investors. They would prefer to place their savings elsewhere. In the age when everyone may invest on many different stock exchanges and choose the one that suits him the best, no stock exchange would accept the behaviour that reduces its attractiveness.

Listing a company on a stock exchange where no strong anti-insider dealing and manipulation policy is led sends a signal to potential investors about the managerial policy. Naturally, it would influence the investors' decision on how much they should allocate in this kind of financial instruments.[63]

The rule of compliance that should be respected on a given stock exchange automatically bound listed issuers and brokers. They both have a contractual link to

[59] ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 17, available through: www.ecgi.org/wp.

[60] ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 15, available through: www.ecgi.org/wp.

[61] BEBCHUK, Lucian, COHEN, Alma, FERRELL Allen, *What Matters in Corporate Governance?,* The Review of Financial Studies, 2009, Vol. 22, No. 2, pp. 783–827.

[62] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, p. 33.

[63] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, pp. 36–37.

the stock exchange. One may wonder how the stock exchange may influence the behaviour of the entities or persons that do not have such a contractual link with it. Among them, many primary as well as secondary insiders can be found. In such a situation Adam C. Pritchard proposes a mandatory contract that would be administered by the broker-dealer.[64] A person willing to enter into transactions on a given stock exchange should agree on the rules and requirements binding in such a case. In such a way a contractual link would be created and one would undertake to comply with the rules applied on the stock exchange.

Thus, a role that the stock exchanges should play is to certify that all the listed companies respect the rules of the good governance and impose the obligation of proper disclosure. That would reduce the information disparities in the market and, in consequence, would increase the liquidity of the stock exchange.[65]

The mandatory disclosing gives more information about the enterprise to the market but also to its shareholders and stakeholders. Thus, modern theory recognise that it facilitate and enhance corporate governance.[66]

Of course stock exchanges are not obliged to deal alone with all the possible problems that may arise from their activity. If an irregularity is observed, like fraud, prosecution should be informed and criminal procedure launched.

If the need of the control exercised by the state authorities was still acknowledged, one solution would consist in allowing the government or a governmental institution to audit the rules of governance imposed by their stock exchange and their respect among all their addressees.[67]

II Education

One of the important elements that would protect investors and increase the confidence of the small market players would be the launching of an educational campaign that would inform them about the rules that smart investors should follow in order to avoid advertisement traps and unnecessary losses.[68] Higher knowledge of investors would help them make more rational choices and be less prone to follow the emotion-based claims.

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[64] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, p. 38.

[65] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, p. 34.

[66] HOPT, Klaus J., *Modern Company and Capital market Problems: Improving European Corporate Governance After Enron*, in: ARMOUR, J., MCCAHERY, J.A. (eds.), After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US, Oxford (Hart), 2006, p. 463.

[67] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, p. 39.

[68] Similarly: ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 50, available through: www.ecgi.org/wp.

It is difficult to describe the shape of the proper educational campaign but it should be addressed not only to adult market players but also to a younger public. The liberal system based on private property is so far the only economic system that allowed the states to reach a high level of development. The other experiments (communistic, socialistic, and anarchic) have not fulfilled the hopes of their authors. Meanwhile, among the younger generation there may be observed a strong anti-capitalistic attitude. E.g. French students use the word "capitalist" as an insult that means, more or less, evil and selfish. It must be admitted that the famous cases of frauds and misappropriations may create the wrong image of the "world of finance" but, nevertheless they should not be able to undermine the foundations of the whole economic system. Hard working, self-development and orientation on personal success should be appreciated as essential for the economic development of the states and not seen as evil.

Educational campaigns could be organised by the administrative entities that control the market and activity of the stock exchanges. More conscious and well-informed market players would more easily observe all abnormal changes in financial instruments value. Moreover, they would not be easily misled by unfaithful advisers, uncertain information or politicians that would try to find a "scapegoat" in order to justify new unnecessary regulations.

Conclusions

The objective of this work was to analyse the relations between properly constructed criminal law and existing insider dealing regulations. The research shows that the application of the criminal law to insider dealing has been made too hastily and without necessary consideration, especially, if one realises how many requirements should be fulfilled to use criminal law in conformity with the principles of criminalisation. The thesis does not attempt to state definitively whether insider dealing is fair or not, whether it is beneficial or harmful for the market. These are the tasks for the economists and ethicists. The author's goal was to demonstrate that application of the criminal law is always linked to interference with basic human rights. And this interference should never take place unless it is necessary and well founded. The orientation on the core human rights protection and the two-step theory of criminalisation provide the tools that may help minimise the risk of the overuse of criminal law.

One is usually afraid of the unknown things. These matters seem to be complicated and dangerous. According to the popular belief, persons who can deal with them deserve admiration but, on the other hand, are suspected of using their knowledge to the detriment of others. Insider dealing is a kind of behaviour that belongs to this group. Reserved only for some, it may provoke doubts about its influence on others' welfare, proper functioning of the markets, and fairness towards other market players.

Insider dealing is prohibited in most of the world's jurisdictions. Two main systems aiming at the protection of the markets against this behaviour, namely the European and American ones, are described in Chapter 1. The former perceives insider dealing as detrimental for markets and undermining confidence of the market players. The latter refers to the notion of property of information and attributes the use of inside information to its author. Both systems apply severe administrative sanctions for non-respect of the prohibition. Additionally, the prosecution of insider dealing in the United States and in most Members States of the European Union may be made on a basis of criminal law. Meanwhile, there is little

I. Seredyńska, *Insider Dealing and Criminal Law*,
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evidence that this kind of behaviour deserves condemnation. Common opinions are not supported by the economic and ethical researches. As it has been presented in second part of the Chapter 1, the specialists in both domains do not agree in their opinion on final evaluation of this phenomenon. Many different arguments are presented by the supporters and opponents of this behaviour but as far no one had procured the final reasoning that would finish the discussion.

Evidently, the legislatures do not share the uncertainty of the researchers and base their decisions about introduction of insider dealing prohibition on other premises. This fact confirms the thesis that decisions about regulating given kinds of human activity are rarely taken on a basis of scientific evaluation. Much more often they refer to popular feelings. One of them is the feeling of vulnerability that provokes a well-known process when, in order to feel secure, individuals agree to limit their personal liberty.[1] In case of insider dealing it is the liberty of trading on a basis of the possessed knowledge that is limited. Another important factor that encourages introduction of restrictions in the domain of insider dealing is the so-called "anticapitalistic mentality", i.e. resentment for those who possess more than others. Especially if it seems that the gain was made effortlessly.[2]

Nowadays everyone faces an increasing number of laws that aim at creation of the secure environment in all domains of the human activity. This security is very often enforced with the use of criminal law. It may lead to the situation described already in the first half of the nineteenth century by Alexis de Tocqueville, i.e. so called "soft despotism".[3] During his analysis of the American democracy, he observed that the state intervenes, with the consent of all governed individuals, into an increasing number of domains and takes care of all the aspects of the human life. In such a situation, the ruler unnoticeably limits the freedom of its citizens and become a tyrant – a "soft" tyrant because the takeover of the individuals' rights was done without violence, has been barely noticed by the members of the society and even welcomed as a lightening of the burden of freedom that weighs on everyone. In consequence, the relation between the state and its citizens is similar to the relation between a parent and his teenage child. A question may be asked on when the child will grow up to become an adult. One does not often realise that the creation of the rules that regulate all the domains put him in a position of a child requiring constant care and control.[4] Individuals accept this governmental intervention in spite of their will to be treated as conscious and responsible persons. They do not realise that the notions of security and freedom are mutually exclusive and the increase in the former leads to limitation of the latter.[5]

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[1] FROMM, Erich, *Ucieczka od wolności*, Warszawa, 1978.

[2] von MISES, Ludwig, *The Anticapitalistic Mentality*, 1956.

[3] de TOCQUEVILLE, Alexis, *Democracy in America*, London, 1994, Vol. II, Book 4, Chap. 6.

[4] As described by Mathieu LAINE in: *La Grande Nurserie : En finir avec l'infantilisation des Français*, Jean-Claude Lattès, 2006.

[5] ALBRECHT, Peter – Alexis, *The Forgotten Freedom, September 11 as a Challenge for European Legal Principles*, Berliner Wissenschafts – Verlag, 2003, pp. 39–45.

The main justification that the Market Abuse Directive offers for its creation is the protection of the confidence for the market of the small market players. For sure, the stock exchange market cannot function properly without the market players that rely on it. *"Absent trust in the integrity of the securities markets, individuals will hoard their money under the proverbial mattress."*[6] However, an objection to the claims of the Directive should be made. An average small market player has limited knowledge about the functioning of the market and the nature of behaviour like insider dealing. The market professionals and legislature's opinion is taken seriously and usually accepted without reflection. Thus, when a judgment is officially presented, stating that insider dealing is wrongful and impedes market performance, most people would simply trust this statement and support the state's actions against insiders. But it has not been proved that, without such regulation, the level of the trust for the market should be lower.

The analysis of the existing regulations that has been conducted in Chapters 1 and 2, regardless of their geographic origins, demonstrates that insider dealing prohibition is based on vague notions and harsh punishments. First of all, the notion of insider dealing is very imprecise. The most flagrant situation may be found in American law where an official definition of this behaviour does not exist. It only emerges from interpretation given by the SEC and courts *ex post,* i.e. in the judicial and administrative decisions. At least, not all specialists accept this legal environment and voices stressing the necessity of clarification of the legal situation of potential insiders can be heard.[7] The European Market Abuse Directive contains various definitions that aim at the unification of the insider dealing prohibition in the Member States. Nevertheless, the examples show that the wording of the Directive leads to many discrepancies between national laws of the Member States. Moreover, even when they rely on similar provisions, competent administrative authorities and courts of various jurisdictions render different verdicts. One of the reasons for this situation is that the difference between a permitted and a prohibited action is very small and, in many cases, depends on the individual opinion of the person who issues the decision. That means that the objective of the European legislature to harmonise the understanding of this notion in the Member States has not been achieved.

The Market Abuse Directive encourages the Member States to introduce the criminal law regulations that would improve effectiveness of the insider dealing prohibition. Chapter 3 examines the requirements of the appropriate application of criminal law and enactment of the new criminal rules. The analysis of the theories of punishment, i.e. the theories that justify the use of criminal law and establish the rules that should be respected in order to punish justly, reveals that the only theory that is compatible with the democratic principles and the respect for the individual

[6] PRITCHARD, Adam C., *Self-Regulation and Securities Markets*, Regulation, Spring 2003, p. 32.

[7] E.g. a recent critique: ROSS SORKIN, Andrew, *So What Is Insider Trading?* The New York Times Dealbook, 25 October 2010, Available at: http://dealbook.blogs.nytimes.com/2010/10/25/sorkin-so-what-is-insider-trading/ (last seen on 15 February 2011).

is based on retribution. According to this theory the punishment is inflicted as an answer for a violation of the most important rules that are at the core of society. All other theories are based on consequentialist premises and use the offender as a tool for social engineering. His punishment is supposed to serve as an example for others and induce other members of the society to decent behaviour. If such an approach was accepted, criminal law would have no limits and the measurement of the appropriateness of its use would be based only on utilitarian calculations.

In the second part of Chapter 3 the two-step approach to the criminalisation was proposed. It is a simple procedure that helps determine whether the legislature should intervene in a given sphere of human activity and whether application of criminal law is in the given case justified. According to this procedure, at the beginning, the issue of the wrongfulness of the considered behaviour should be analysed. If it is declared to be wrongful, the need for legislative intervention arises. Nevertheless, it is the second step, i.e. the use of principles of criminalisation, that gives a final answer on whether a new criminal rule may be introduced to the legal system.

As it was presented in the part dedicated to the theories of wrongfulness, concentration on the core human rights, i.e. respect for the individual's life, his freedom, and property constitutes the best basis for the first step of the criminalisation. Other theories, founded on moralism, paternalism or stating that legislature's intervention should not be limited by other factors than its will, risk of creation of a legal system where criminal law would be applied too often, maybe even as a *prima ratio*. On the other hand, there are theories, like the harm theory, that, if understood strictly, are too narrow to assure the proper protection of an individual. As it was said, the verification of whether the given behaviour is wrongful is a first prerequisite for criminalisation. However, it is not a sufficient condition to punish it with the help of criminal law. Other legal means may be very often successfully applied.

The second step, i.e. the application of principles of criminalisation, refers to the basis of the European criminal law tradition. After their long presence in the writings of philosophers they have been elaborated more than two hundred years ago in the age of Enlightenment. The principles indicate whether application of criminal law is necessary or whether other legal tools may deal with the issue. Moreover, they specify the minimal standards that a new criminal rule, if created, should fulfil. The principle of legality imposes minimal conditions that have to be respected to introduce a new, properly enacted, binding and enforceable legal rule. The principles of subsidiarity and proportionality underline the importance of alternative means that may be used to deal with the unwanted phenomenon and exclude application of too harsh but also too lenient legal tools. The requirement of culpability averts the creation of offences where no-one analyses the attitude towards the act that had an alleged offender. Although examination of this aspect of an act makes the prosecution's work much harder, it protects individuals against facing criminal liability for the breaches that were made without moral responsibility of their actor. Finally, the *in dubio pro libertate* principle gives a final indication and helps to evaluate the real need of application of criminal law. It

should be underlined, that two-step criminalisation is not a mathematical formula. It does not determine the content of the rule. But it helps evaluate the analysed phenomenon, gives indications concerning the shape and the scope of application of the rules.

The two-step criminalisation test may also be applied to evaluate existing regulations. In Chapter 4 such an analysis of the current criminal regulation of insider dealing was made. It demonstrated that many elements of the prohibition do not comply with the principles and enactment of this prohibition does not fulfil the requirement of a proper criminal regulation. Thus, the issue of decriminalisation and application of different legal branches arises. The decision about decriminalisation is always difficult to take. Undertaking such an act may create an impression that the legislature has changed its opinion about the wrongfulness of decriminalised behaviour. Although in some cases it may be true, in others the legislature may simply wish to replace a regulation based on criminal law by an act that imposes other kind of sanctions. An explanation referring to the principles of the proper use of criminal law and human rights protection may seem unconvincing. For this reason, an opinion may be presented that introduction of a new criminal law to any legal order should be made more carefully. The analysis and consideration would help avoid the situations when the need of decriminalisation arises. Secondly, although there may be some counterarguments, sometimes one must decide to make an unpopular decision to restore the order interfered by predecessors.

When the issue of the criminalisation of the insider dealing is analysed, one cannot forget that administrative and civil law also offer valuable solutions that may be used. Chapter 4 examined whether they may effectively regulate the possible problems arising from the insider dealing. The application of administrative law is justified in all the spheres of human activity where the pressure is put on the maintenance of an order and good functioning of the given domain. It should be underlined that even the Market Abuse Directive creates a primary obligation to introduce administrative solutions. Application of administrative sanctions is efficient and does not entail the social burdens of the criminal prosecution. Nevertheless, the concerns linked to imposition of administrative sanctions arise when the existing in the Europe systems are analysed. Imposition of the sanctions which maximal amount is not pre-determined by the law or the administrative authority that in the decision-making process does not rely on all gathered in given case evidences, as it could be observed in France and England,[8] are inacceptable. Thus, some changes should be introduced in the national legal systems that would follow the indications given by the ECHR for the "criminal cases".[9] However, more justified would be speaking not about "criminal cases" but about minimal standards that should be respected in a democratic society in every kind of proceeding.

[8] See: sections "France" and "England and Wales" in Chap. 2.

[9] See: sections A.II in Chap. 3.

Alongside the administrative rules or independently of them, civil law may be used. Its application to insider dealing may be twofold. First, it may function as a tool that allows establishing the proper rules and relations within a company that "creates" inside information. Civil contracts may establish the rules of the proper behaviour of the insiders and eventual conditions under which they may use the information. In case of violation, the issuer would be entitled to compensation of the suffered losses or to recovery of a contractual penalty. The second possibility is the application of general compensation rules that allow market players to recover possible losses arising from insider deals. In order to facilitate launching the lawsuits, especially in cases when numerous persons would be harmed by one act and the amount of the losses was not high enough to motivate them to individual actions, the development of the class action should be considered. It would facilitate the access to the court, lower the costs of procedure and legal services and, also assure unification of the verdicts rendered in similar situations.

Finally, one may consider application of the tools that are outside the traditional intervention of the legislature. Markets may and should try to deal with unwanted behaviour on their own and discourage the market participants that do not share their principles. Thus, the importance of the codes of good conduct and rules of the corporate governance should be underlined. Creation of such rules and obligation for the market participants to respect them should influence the atmosphere of the markets and restore some confidence with the investors. Nevertheless, corporate governance should not be used merely as a "box ticking",[10] i.e. a mechanical fulfilment of the requirements in order to be backed up for an external control. If the members of the governing bodies only formally comply with the rules, it will not have a visible impact on the company's behaviour. It should be remembered that Enron, just before the famous scandal, had complied with practically all corporate governance's requirements set up afterwards by the famous Sarbanes-Oxley Act.[11] It did not, however, prevent its final catastrophe and downfall. The moral integrity of those who are entitled to manage the enterprises and deal using someone else's money seems to be the most important.[12] Unfortunately, this moral integrity cannot be achieved through simple introduction of formal rules. According to Montesquieu's writings, a republican, democratic, system, for proper functioning, requires virtue from its members.[13] That means the constant need of self-development and attachment to the values. Otherwise, all laws will be just the obstacles that may be disregarded. Besides, the existence of such an environment

[10] SISON, Alejo José G., *Corporate Governance and Ethics An Aristotelian Perspective*, Edward Elgar Publishing, Cheltenham, UK, Northampton, MA, USA, 2008, pp. 25–43.

[11] The Sarbanes–Oxley Act of 2002 (Public Law 107-204, 116 United States Statutes at Large 745, enacted July 30, 2002).

[12] SISON, Alejo José G., *Corporate Governance and Ethics An Aristotelian Perspective*, Edward Elgar Publishing, Cheltenham, UK, Northampton, MA, USA, 2008, pp. x–xi.

[13] de MONTESQUIEU, Charles de Secondat, *The Spirit of Laws*, Kitchener, 2001, p. 37.

deprived of any virtue would probably result in constantly widening scope of criminal regulations enacted in order to deal with arising social concerns.

Finally, having analysed the actual and possible insider dealing regulations, it should be noted that the examination of the insider dealing laws and cases demonstrate that if something is detrimental for the proper functioning of the markets and the trust the market players have for them is not insider dealing *per se* but the non-disclosure of the inside information to the public or late or incomplete disclosure. Thus, the importance of the proper and respected disclosure rules should be postulated. Development of the proper disclosure requirements does not generally interfere with freedom[14] (understood as personal freedom of an individual but also as the freedom of an enterprise to compete with other market entities). Therefore, development of the rules that impose obligation of proper and fast disclosure could reduce the risk of insider dealing (there is no insider dealing when there is no inside information) and improve market performance without making a reference to criminal law and prosecution of insiders. The economic analyses demonstrate that, without an existing legal obligation, issuers have little incentives to disclose important for the market players information. Thus, there should be a legal framework that ensures that they do so. These important data might include information about the transactions in the financial instruments that the insiders intend to make.[15]

[14] HOPT, Klaus J., *Modern Company and Capital market Problems: Improving European Corporate Governance After Enron*, in: ARMOUR, J., McCAHERY, J.A. (eds.), After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US, Oxford (Hart), 2006, p. 463, ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 15, available through: www.ecgi.org/wp.

[15] ZINGALES, Luigi, *The Costs and Benefits of Financial Market Regulation*, Law Working Paper No. 21/2004, p. 40, available through: www.ecgi.org/wp.

Annex 1

Comparative table on insider dealing regulations in France, England and Wales, Luxembourg and Poland

Definition of		France	England and Wales	Luxembourg	Poland
Inside information	Administrative law	Yes	Yes	Common definition	No
	Criminal law	Yes	Yes		Yes
Insider	Administrative law	Yes	Yes	Common definition	No
	Criminal law	Yes	Yes		Yes
Behaviour	Administrative law	Yes	Yes	Common definition with additional requirement of pursuit of an illegal profit for the purposes of the criminal law	No
	Criminal law	Yes	Yes		Yes
Sanctions	Administrative law	Yes	Yes	Yes	No
	Criminal law	Yes	Yes	Yes	Yes

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