

19 March 2018



Eral Knight
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Dear Mr Knight

European Union (Withdrawal) Bill 2017—clause 6 and judicial interpretation

As you know, the role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

Following the referendum in June 2016, in which the U.K. voted to withdraw from the European Union, the FMLC established an Advisory Group of experts to give direction to the Committee's work relating to Brexit. Members of that Advisory Group drew the FMLC's attention to potential legal uncertainties arising from provisions in the European Union (Withdrawal) Bill (the "**Withdrawal Bill**"), which will, post-Brexit, govern the interpretation by U.K. courts of E.U. concepts.¹

The Withdrawal Bill provides, in essence, for the incorporation of E.U. legislation, as "operative immediately before exit day", into domestic law. Clause 5 of the Withdrawal Bill states that the principle of the supremacy of E.U. law will not apply to any enactment or law passed or made on or after exit day, except so far as relevant to the interpretation, disapplication or nullifying any enactment or law passed or made before exit day. Clause 6, quoted below, provides guidance on the relationship between courts in the U.K. and the European Court of Justice (the "**ECJ**").

Interpretation of retained EU law

(1) A court or tribunal—

(a) is not bound by any principles laid down, or any decisions made, on or after exit day by the European Court [...]

(2) A court or tribunal *need not have regard* to anything done on or after exit day by the European Court, another EU entity or the EU but *may do so if it considers it appropriate to do so* (emphasis added).

(3) Any question as to the validity, meaning or effect of any retained EU law is to be decided, so far as that law is unmodified on or after exit day and so far as they are relevant to it—

(a) in accordance with any retained case law and any retained general principles of EU law [...]

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Where ECJ case law exists in relation to retained E.U. law, therefore, U.K. courts are instructed to follow such decisions;² correspondingly, where the meaning of an autonomous E.U. term or concept is defined before exit day, U.K. judges will follow that interpretation. Where the meaning of terms is not fixed by exit day—or their interpretation is discussed and adjudicated upon by the ECJ post-Brexit—there remains ambiguity as to how U.K. courts should proceed.³

In the absence of statutory direction, U.K. courts customarily treat foreign court judgments as persuasive but short of binding. The introduction of the concept of “appropriateness” in clause 6(2) gives rise to unforeseen complexities as the Withdrawal Bill does not offer any guidance as to the meaning of “appropriate”. The term “need not have regard” is another area of potential difficulty—the FMLC notes the use of the term “have regard” has caused interpretational difficulties in the past.⁴

It is the view of the FMLC that such ambiguity in the guidance offered to judges will present legal uncertainty with significant market impact, supplementing the operational challenges caused by the increased likelihood of inconsistent first-instance judgments and the lengthier-than-usual waiting times for hearings at the Court of Appeal and Supreme Court, especially in the event that European and U.K. judges take differing approaches to interpretation. It might be helpful to reflect on a number of cases in which the interpretation of key E.U. regulatory concepts has had the ability significantly to affect the financial markets.

One such example is the definition of “derivative” (and, correlatively, the definition of “spot”, since “spot” contracts are not “derivative” contracts) under the regulatory regime for markets in financial instruments.⁵ Foreign exchange derivatives such as forwards are regulated under this regime but spot foreign exchange contracts are not. The settlement cycle, however, means that spot contracts are settled forward of the parties entering into the contract. Thus, the boundary between “spot” and “forward” is a nuanced one with a penumbra of uncertainty. The U.K. Financial Services Authority (“FSA”)—and subsequently the Financial Conduct Authority (“FCA”)—developed a practice of using the concept of “commercial purposes” as the basis for distinguishing the two contracts but other E.U. Member States took a different approach. Owing to the substantial uncertainty to which this divergence gave rise, the European Commission was asked for guidance by the European Securities Markets Authority (“ESMA”) and issued a retrospective opinion under Directive 2004/39/EC on markets in financial instruments (“MiFID I”). A legislative definition was then introduced for the purposes of Directive 2014/65/EU on markets in financial instruments (“MiFID II”). It is possible, however, that given the importance of the issue and the impact of such divergent approaches, this issue would have become a question for the ECJ to address in the absence of a legislative definition.

It is also possible that the ECJ would have adopted an interpretation with which the FCA would, questions of comity aside, not have been inclined to concur. Post-Brexit, such divergence could well see the question on the meaning of “spot contract” referred to the U.K. judiciary. The risks which the courts’ approach might pose for the markets would be the alternate risks of inadvertently regulating an unregulated and thriving foreign exchange spot market, which is essential to commercial activity of all kinds, or deregulating certain foreign exchange derivatives markets and potentially jeopardising an equivalence decision. Given the significance of the question to the financial markets, its evident impact on the conduct and nature of foreign exchange business, the size of the foreign exchange markets in London and the highly technical material which would be necessary to reach an informed decision on the point, the U.K. courts would likely find it helpful to receive guidance not only on the technical issues but also

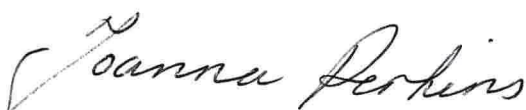
on the degree to which their decision should “track” or even “reflect” the decision of the E.U.

Another past example is the question of what it means to be an “insider” for the purposes of the insider trading regime first established under Directive 2003/6/EC on insider dealing and market manipulation (the “**Market Abuse Directive**” or “**MAD**”).⁶ The question of whether insider trading can comprise trading while in possession of inside information or, more restrictively, comprises only trading on the basis of inside information was one which was settled by the ECJ (in favour of the wider definition) during a period in which the FSA’s preferred approach was a narrower and therefore divergent interpretation. Regulation (EU) No 596/2014 on market abuse (the “**Market Abuse Regulation**” or “**MAR**”) reflects the approach adopted by the ECJ. If this question were to have arisen under the Market Abuse Directive for consideration after Brexit, it would doubtless have reached the U.K. courts which would have had to consider the proper deference to be given to the ECJ’s judgment. The risks which the courts’ chosen approach might pose include the risk of the U.K. markets being perceived to be less well-regulated than E.U. markets, with a potential impact, again, on supervisory and equivalence decisions.

The FMLC recommends, therefore, that careful thought be given to the practical use of the “appropriateness” test. It would be beneficial if HM Government were to provide the judiciary with either principles by which it can evaluate consistently whether consideration should be given to post-Brexit ECJ judgments or with a mechanism which might confer aides to interpretation. While the FMLC recognises that the degree of influence the ECJ’s decisions may have on judgments by U.K. judges depends to a certain extent on the composition of the final Withdrawal Agreement, it considers it essential that HM Government makes independent provisions which can guide judicial deliberation. One such provision might be to confer upon judges the ability to request from relevant bodies, such as the FCA, *amicus briefs* which provide judges with the necessary background.⁷

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,



Joanna Perkins
FMLC Chief Executive

¹ The European Union (Withdrawal) Bill 2017 is available at <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0005/18Q05.pdf>. The progress of the Withdrawal Bill can be monitored at <https://services.parliament.uk/bills/2017-19/europeanunionwithdrawal.html>.

The FMLC had previously written to the Ministry of Justice in August 2017 to draw attention to other legal complexities arising from the Withdrawal Bill (available at: http://www.fmlc.org/uploads/2/6/5/8/26584807/letter_to_moj_on_withdrawal_bill.pdf).

² The U.K. Supreme Court is given, by means of point 4(a) in clause 6, the power to depart from ECJ decisions on the same basis as it is currently able to depart from its own decisions.

³ The FMLC observes that this ambiguity was noted by the former President of the Supreme Court, Lord Neuberger, who remarked in the media that judges would require guidance from HM Government on how U.K. courts should interpret European concepts and judgments post-Brexit. See, Coleman, C., "U.K. judges need clarity after Brexit - Lord Neuberger", *BBC News*, (8 August 2017), available at: <http://www.bbc.co.uk/news/uk-40855526>.

⁴ For example, in relation to section 172 of the Companies Act 2006 (see, *R (on the application of People & Planet) v HM Treasury* [2009] EWHC 3020 (Admin) and S. F. Copp 'S. 172 of the Companies Act 2006 Fails People and Planet' [2010], *Company Law* 406). The Law Society had raised a concern that the provision could raise the spectre of courts reviewing business decisions taken in good faith by subjecting such decisions to objective tests, with serious resulting implications for the management of companies by their directors. See, the Law Society's 'Proposed Amendments and Briefing for Parts 10 & 11' (issued 23 January 2006);

⁵ The MiFID regulatory regime comprises Directive 2004/39/EC on markets in financial instruments ("MiFID I"), which has now been replaced by Directive 2014/65/EU on markets in financial instruments ("MiFID II") and Regulation (EU) No 600/2014 on markets in financial instruments ("MiFIR").

⁶ "Inside information", defined in Article 7, has been interpreted widely by ECJ under MAD I. To trigger the prohibition, information must be "precise", non-public and price-sensitive. Under Article 8, a breach occurs where a person possesses inside information and uses it by acquiring or disposing of (related) financial instruments or by cancelling or amending an order where the order was placed before the person obtained inside information.

MAR creates a presumption that a person in possession of inside information who carries out transactions connected with that information is deemed to have used that information, reflecting the ECJ decision in *Spector Photo Group v CBFA* [2009] C-45/08. Under Article 9 the presumption is rebuttable where one of the following legitimately occurs:

- the natural person who decides to enter into a transaction on behalf of a legal entity is not himself in possession of inside information or influenced by one who is (a "Chinese Wall" defence);
- a market-maker or broker is acting in the normal course of that function;
- the person who trades is subject to a pre-existing obligation to enter into the transaction when he acquires the inside information;
- the insider is proceeding with a merger or takeover, prior to public disclosure, and the information relates to that activity;
- the inside information is that the insider himself has decided to make this trade.

There is no general defence in respect of due care and diligence or safe systems and controls.

⁷ In view of the fact that this solution would require the cooperation of the U.K. regulatory authorities, Sean Martin and Sinead Meany took no part in the preparation of this letter and the views expressed should not be taken to be those of the FCA and the Bank of England.