

Tesco market abuse

FCA requires redress scheme but decides not to impose penalty in light of co-operation and DPA

The FCA has today issued a Final Notice against Tesco plc and Tesco Stores Limited (together "**Tesco**") stating that Tesco committed market abuse on 29 August 2014 when Tesco plc issued a trading update containing an overstated profit forecast. The FCA found that the update created a false market in Tesco plc shares until 22 September 2014 when Tesco plc made a further announcement identifying the overstatement.

The FCA has decided not to impose a financial penalty in respect of this market abuse, but has instead imposed a requirement on Tesco to pay compensation to net purchasers of its shares and listed bonds between 29 August 2014 and 22 September 2014.

In parallel it has been announced that the SFO and Tesco Stores Limited have reached an agreement which, if approved by the Crown Court at a public hearing on 10 April 2017, will result in a Deferred Prosecution Agreement in connection with "substantially similar conduct" to that described in the Final Notice (the "**DPA**"). If approved, the DPA will result in Tesco Stores Limited paying both a financial penalty of £128,992,500 and the SFO's full costs. The other terms of the proposed DPA are not yet known.¹

Key Points

- This is the first time the FCA has used its administrative powers under section 384 FSMA to order restitution for market abuse against a listed company.
- The FCA estimates that the total amount of compensation that may be payable under the redress scheme will be approximately £85 million, plus interest.
- The decision not to impose a penalty on Tesco is based in part on the fact that Tesco Stores Limited has agreed to enter into the DPA (despite the fact that the

DPA is yet to receive final approval from the Crown Court).

- The case is therefore an example of how the FCA will work alongside the SFO to resolve investigations.
- The redress scheme will be administered by KPMG and will entitle eligible claimants to compensation based on the fall in the price of relevant securities following the announcement on 22 September 2014.

Facts

The background facts are well-known. On 29 August 2014, Tesco plc published a trading update in which it stated that it expected trading profit for 2014/15 to be in the range of £2.4bn to £2.5bn and trading profit for the six months ending 23 August 2014 to be in the region of £1.1bn.

On 22 September 2014, Tesco plc announced that it had identified an overstatement of its expected profit, principally due to the accelerated recognition of commercial income and delayed accrual of costs. Tesco plc made subsequent announcements quantifying the overstatement and identifying overstatements of commercial income prior years.

The FCA's Finding of Market Abuse

The legacy section 118(7) FSMA market abuse offence consisted of "*the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.*"²

Whilst the FCA may impose a financial penalty for market abuse falling within the scope of 118(7) FSMA, it may, instead, publish a statement to the effect that a person has engaged in market abuse.

¹ The DPA concerns only the potential criminal liability of Tesco Stores Limited. It does not address whether liability of any sort attaches to Tesco plc or any employee or agent of Tesco plc or Tesco Stores Limited.

² Section 118(7) FSMA has now been repealed (along with the other market abuse offences in section 118 FSMA). Article 12(1)(c) of the Market Abuse Regulation contains an equivalent offence.

Unsurprisingly, the FCA has found that the information in the August trading update gave a false or misleading impression as to Tesco plc shares. This had been clear from Tesco plc's own announcements and their impact on the market.

The more difficult question for the FCA to determine was whether Tesco knew, or could reasonably have been expected to have known, that the information in the August statement was false or misleading.

In this regard the FCA found that both Tesco Stores Limited and Tesco plc knew, or could reasonably have been expected to know, that the information in the August statement was false or misleading. As regards Tesco plc the FCA found that there was knowledge at a sufficiently high level, but below the level of the Tesco plc Board, for that knowledge to constitute the knowledge of Tesco plc "within the specific context of, and for the purposes of, market abuse". However, the FCA has stated expressly that it does not make any finding that the Tesco plc Board knew, or could reasonably be expected to have known, that the information in the August statement was false or misleading.

The FCA does not set out the facts on which these findings are based. This may be to avoid prejudicing the ongoing criminal investigations. The wording adopted suggests that the FCA wishes to draw a distinction between the identification doctrine applicable for the purposes of corporate criminal liability and the identification doctrine applicable for the purposes of section 118(7) FSMA. In other words the FCA is suggesting that those who may be the "directing mind and will" for the purposes of section 118(7) may not be the "directing mind and will" for the purposes of criminal liability.

The FCA has not made any finding of market abuse or any other regulatory breach in respect of periods before the August trading update.

The FCA's decision not to impose a penalty – cooperation and the DPA

The FCA has exercised its discretion under section 123(3) FSMA not to impose a financial penalty on Tesco, but instead to publish a statement to the effect that Tesco has engaged in market abuse.

DEPP 6.4.1G provides that the FCA will consider all the circumstances of the case when deciding whether or not to impose a penalty. DEPP 6.4.2 contains a non-exhaustive list of factors that may be particularly relevant.

The FCA has stated that the following factors were relevant to its decision:

- the fact that Tesco Stores Limited will pay a substantial penalty pursuant to the DPA;
- the exemplary co-operative approach taken by Tesco plc and Tesco Stores Limited both with the FCA and the SFO;
- the exemplary conduct of the Tesco plc Board in the approach it has taken since the discovery of the overstatement in September 2014;
- the steps that both companies have taken since the misconduct to ensure that similar misconduct will not occur in future.

The FCA gave further details of Tesco's co-operation at paragraph 4.11 as follows:

The two companies have been proactive in the offering of information and have responded promptly and constructively to requests made of them. Furthermore, both refrained, at the FCA's request, from interviewing witnesses or taking statements; they disclosed voluntarily material which appeared to them to be significant to the FCA's enquiries; and they generally helped to facilitate a swift conclusion to the FCA's enquiries.

The publication of the Final Notice and announcement of the proposed DPA in parallel, along with the willingness of the FCA to take account of the impact of the DPA, reveal increasing co-operation between the FCA and the SFO and sophistication of approach in reaching joint settlement. It illustrates the FCA considering co-operation with, and the financial impact of sanctions imposed by, different regulators and prosecutors relating to the same conduct at a group-wide level.

It is interesting to note that the FCA has taken account of the DPA before it has been given final approval by the Crown Court (expected on 10 April 2017). Although, as at the date of the Final Notice, the Crown Court has declared that entering into the proposed DPA is likely to be in the interests of justice and that the proposed terms of the DPA are fair, reasonable and proportionate, the court retains discretion to decline to give it final approval. As Leveson LJ stated in his judgment in *Serious Fraud Office v Standard Bank Plc* at [4] "Thus, even having agreed that a DPA is likely to be in the interests of justice and that its proposed terms are fair, reasonable and proportionate, the court continues to retain control and can decline to conclude that it is, in fact, in the interests of justice or that its terms are fair, reasonable and proportionate."

The decision to use section 384 FSMA

Under section 384 FSMA, the FCA has the power to order restitution in respect of market abuse. The FCA has published guidance on the exercise of this power in Chapter 11 of its Enforcement Guide.

That guidance provides that in considering whether to exercise the section 384 power:

"the FCA will consider other ways that persons might obtain redress, and whether it would be more efficient or cost-effective for them to use these means instead; and any proposals by the person concerned to offer redress to any consumers or other persons who have suffered loss, and the adequacy of those proposals. The FCA expects, therefore, to exercise its formal restitution powers on rare occasions only."

The guidance goes on to list various relevant factors including whether those who have suffered loss can bring their own proceedings.

This case represents the first time the FCA has exercised its section 384 power by ordering restitution against a listed company. It is noteworthy that the FCA has chosen to exercise its formal power in this case notwithstanding the level of co-operation provided by Tesco.

The use of section 384 is in keeping with Mark Steward's (Director of Enforcement and Markets Oversight) stated intention to exercise the full suite of the FCA's enforcement powers and to seek alternatives to financial penalties in appropriate cases.

The scheme

The scheme will be administered by KPMG with oversight from the FCA.

Details of the scheme are available in the Final Notice and on the KPMG website at:

<https://home.kpmg.com/uk/en/home/services/advisory/tesco-scheme.html>

Those receiving redress under the scheme will be required to enter into a release agreement covering any claims arising out of, or in any way connected with, the publication of the August trading update. This would include any potential claim under section 90A and Schedule 10A FSMA.

The compensation scheme will launch by 31 August 2017.

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