

Bear Raids and Bust-ups: Requests for Disclosure from Third Parties

July 10, 2020 Markus Esly

PRACTICES International Arbitration, Litigation

A recent decision of the Commercial Court concerning alleged stock market abuse illustrates how the English Courts balance the interests of a party who considered itself to have been the victim of wrongdoing against those of investors who wish for their transactions to remain confidential and the orderly operation of the stock exchange. In *Burford Capital Ltd v London Stock Exchange Group Plc* [2020] EWHC 1183, the claimant sought extensive disclosure from the London Stock Exchange (“LSE”) relating to about 360,000 transactions in its shares, alleging unlawful market manipulation. In deciding the application, Andrew Baker J provided a helpful review of the principles of English that govern pre-action disclosure pursuant to so-called “*Norwich Pharmacal*” orders.

A bear raid on Burford

Burford Capital provides litigation funding. Its shares are listed on the Alternative Investment Market (“AIM”). AIM is owned and operated by the LSE. At lunchtime on 6 August 2019, Burford’s share price stood at £13.92. In the course of the afternoon, the price then fell by 18.8%. The following day, 7 August 2019, was worse for the company. The share price tumbled by 46.5% over the course of the day’s trading. When the market closed, Burford shares were worth £6.05. That was 56.5% lower than two days earlier. Burford’s entire issued share capital, which had been valued at around £3 billion, was worth less than £1.7 billion. The market had reacted to a very negative report about Burford prepared by Muddy Waters, a US investment and advisory group. At the same time, Muddy Waters had also mounted a short selling attack, or a so-called ‘bear raid’, on Burford.

Short selling is considered an aggressive, though not unlawful, method of making money on the stock market. A short seller bets on a fall in the share price of the target company. They borrow shares in the target company from a broker, which are then sold at the current market price. The short seller now counts on the price dropping, so that they can buy the borrowed shares back for less and return them to the broker. The difference in price is the short seller’s profit. However, if the share price rises, the short seller faces a loss. A short seller might, therefore, be tempted to time their play such that negative information about the target company depresses the share price just after they sold their shares. That, however, could well amount to unlawful market manipulation.

A war of words

Events kicked off on Twitter. At 1:30 pm on 6 August 2019, Muddy Waters tweeted:

“Muddy Waters is now in a blackout period until tomorrow 8 am London time when we will announce a new short position on an accounting fiasco that’s potentially insolvent and possibly facing a liquidity crunch. Investors are bulled up about this company. We’re not.”

Burford had an inkling that they might be in Muddy Water’s sights. They therefore released a pre-emptive statement at 7:00 am, before the London markets opened, warning investors that the company might be the target of a potential:

“‘bear raid’, ... where short sellers take on a short position in a company's stock and then engage in claims about the company in an effort to alarm investors.”

At 8:53 am, Muddy Waters emerged from the blackout and tweeted a link to a highly critical write up of Burford published on its website, whilst announcing that it was “... *Short Burford Capital*”. The report on Burford came very close to alleging that the company fraudulently misrepresented its earnings, comparing its accounting practices to Enron, and claiming that Burford had been guilty of “... *egregiously misrepresenting*” its returns on investments and the state of its business, which was, Muddy Waters claimed, “... *arguably insolvent*.” Burford quickly published a detailed point-by-point rebuttal of the allegations, announcing that it would go on the counteroffensive as its “... *early investigation already shows the hallmarks of market manipulation*.”

Ultimately, Burford took the matter to the Commercial Court. However, the defendant in Burford’s action was not Muddy Waters, but the LSE. In the litigation, it was not suggested that Muddy Waters’ tweets or actions in shorting Burford had been unlawful or amounted to tortious conduct under English law. Briefly, it appears that Muddy Waters had complied with the regulatory disclosure requirements for holding short positions under EU Short Selling Regulation – as the Financial Conduct Authority (“**FCA**”) had confirmed by way of correspondence. The ‘bear raid’ carried out by Muddy Waters itself had been comparatively small: Muddy Waters had been short 0.71% of Burford’s ordinary share capital, which was worth about £21.5 million on 5 August 2019. Muddy Water’s profit after the fall of 6 and 7 August 2019 appears to have been around £8.5 million. Burford’s entire issued share capital, however, had fallen by £1.3 billion.

Burford’s claim in the Commercial Court

Burford’s claim in the Commercial Court asserted that there had been widespread and clandestine unlawful market manipulation, involving ‘spoofing and layering’. Burford’s allegation was that a large number of ‘sell orders’ had been placed for Burford shares. These orders would be advertised by the LSE’s trading platforms. Such extant ‘sell orders’ would have the effect of depressing the share price, because they signalled an exodus of investors. Where ‘spoofing or layering’ takes place, such fake orders are posted on one side of the trader’s order book (here, the sell side), while genuine orders are placed on the other side (the buy side). Once the genuine order trades, it is possible for the fake orders to be cancelled. Such cancellations must generally happen very quickly, which is why ‘spoofers’ tend to use algorithmic trading software. While the fake orders remain on the book before the computer programme removes them, however, they are visible to others and can influence the price for the shares in question.

Burford’s case was that many of the ‘sell orders’ for its shares were not genuine, and that those who had placed them had no real intention of closing any trade. Burford did not know the identity of the alleged perpetrators as these details are held confidentially on the trading platforms. However, the LSE would have the information that would allow Burford (as it maintained) to ascertain if there had been misconduct.

If the dramatic collapse of its share price had been due to unlawful market manipulation, then, as counsel for Burford put it, the ends of justice demanded that the Court lend its assistance to identify those responsible so that Burford could then (i) pursue claims in tort, (ii) bring a private prosecution for financial crimes or (iii) try and persuade the FCA or the Crown Prosecution Service to bring a public prosecution. The LSE countered that there was nothing to suggest that the sell-off of Burford shares had been anything other than a genuine market response to the disclosure of damaging information about the company: such ‘herd behaviour’ was not out of the ordinary, or by itself suggestive of any wrongdoing.

Looking at Burford's case in some more detail, this was based on the EU Market Abuse Regulation (the "**Regulation**"), Article 15 of which prohibits anyone from engaging in market manipulation. For present purposes, the relevant prohibited conduct was to send false market signals within the meaning of Article 12(1)(a)(i):

"(a) entering into a transaction, placing an order to trade or any other behaviour which: (i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument ..."

Burford had identified 360,000 so-called 'share order events' relating to its ordinary shares, which had been posted on the LSE's trading platforms on 6 and 7 August 2019. For each of those share order events, Burford required disclosure of:

"The names of the natural or legal persons, or third party entities (including but not limited to natural persons, brokers, banks and other financial institutions) which submitted the Share Order Event, including the names of the members or participants of the trading venue who submitted the Share Order Event to the trading venue, and the names of the client on whose behalf the member or participant of the trading venue submitted the Share Order Event to the trading venue."

Burford sought a further dozen specific pieces of information in relation to these share order events. The LSE objected on the basis that this was really a fishing expedition that the Court should not entertain.

Norwich Pharmacal

Burford relied on the discretionary jurisdiction of the English Courts to order disclosure of information against respondents who are in the position of third parties, named after the decision in *Norwich Pharmacal Co v Customs and Excise Commissioners* [1973] UKHL 6. Lord Reid stated the principle as being that:

"... If through no fault of his own a person gets mixed up in the tortious acts of others so as to facilitate their wrong-doing he may incur no personal liability but he comes under a duty to assist the person who has been wronged by giving him full information and disclosing the identity of the wrongdoers. I do not think that it matters whether he became so mixed up by voluntary action on his part or because it was his duty to do what he did. It may be that if this causes him expense the person seeking the information ought to reimburse him. But justice requires that he should co-operate in righting the wrong if he unwittingly facilitated its perpetration."

Their Lordships explained that the interests of a claimant seeking *Norwich Pharmacal*, who had been the victim of a tort, and the defendant were not (at least in the eyes of the law) truly opposed. If an order is made, the defendant will not lose anything other than the administrative costs and expenses of procuring the information. The answer to any concern that the defendant's business might suffer because future customers might be put off is, their Lordships felt, that the defendant should not have done business with wrongdoers in the first place. A *Norwich Pharmacal* defendant is in substantially the same position as someone who is served with a *subpoena*:

"... which, in total disregard of his probable loss of time and money, forces him to attend the court for the very same purpose as that for which discovery is ordered, namely, to assist a

private citizen to justify a claim in law. The policy of the administration of justice demands this service from him.”

In *Norwich Pharmacal* itself, the claimant was a US pharmaceutical company which owned a patent for furazolidone, an antimicrobial agent previously used to treat gastric infections (but which has been banned in the European Union since 1995 and in the United States since 2009). The claimant believed that the patent was being infringed by illicit imports into the United Kingdom of furazolidone manufactured abroad. It sought an order from the Customs and Excise Commissioners that they disclose the names and addresses of the importers. The House of Lords restored the decision of the trial judge to grant the order, finding that it did not matter that the defendants had come into the possession of the information in performing their statutory duty.

The first hurdle that a claimant applying for a *Norwich Pharmacal* order must overcome is (or so it was thought) establishing a good arguable case that it had been the victim of wrongdoing. The wrongdoing in question may consist of a crime, tort, breach of contract or an equitable wrong. The Court does not need to be persuaded that the claimant’s case that there was such wrongdoing is more likely to succeed than not, but the matter must be more than just capable of serious argument. The concept of a ‘good arguable case’ is not easily described in the abstract, and much will depend on the facts of the case. As will be seen, in deciding Burford’s application, Andrew Baker J appears to have refined the role played by the apparent strength of the claimant’s case somewhat. However, it remains true that the stronger the claimant’s case appears, the more likely the Court will be to grant the relief sought.

In 2002, the House of Lords determined that it was not necessary for the claimant to have an intention to actually bring proceedings against any wrongdoer who might be identified by the disclosure (*Ashworth Hospital Authority v MGN Ltd* [2002] UKHL 29). A separate question, however, is whether the existence of a cause of action vested in the claimant against any wrongdoer was a prerequisite for the relief: in other words, did the claimant have to establish that, in principle, it could sue the wrongdoers directly? The purpose of the disclosure would then be to allow the claimant to decide whether it wishes to seek redress through formal proceedings. Burford argued that such a direct cause of action was not necessary. It contended that it was sufficient for there to be a legitimate purpose for the disclosure, which justice demanded should be supported.

The LSE disagreed. It further argued that Burford’s request was far too wide, reminding the Court that the *Norwich Pharmacal* jurisdiction was exceptional and should be narrowly confined. As Flaux J noted in *Ramilos Trading Ltd v Buyanovsky* [2016] EWHC 3175 (Comm):

“... the [Norwich Pharmacal] jurisdiction cannot be used for wide-ranging discovery or the gathering of evidence, but is strictly confined to necessary information ...”

“... [it] remains an exceptional jurisdiction within a narrow scope. The court will not permit the jurisdiction to be used for wide-ranging disclosure or gathering of evidence, as opposed to focused disclosure of necessary information ... Furthermore, it is impermissible to use the jurisdiction as a fishing expedition to establish whether or not the claimant has a good arguable case ...”

In the LSE’s case, the exceptional nature of the relief did not warrant extending the circumstances in which it could be granted to include situations where the claimant had no right of recourse against the wrongdoers.

Andrew Baker J was not prepared to decide whether there was a requirement for a direct cause of action, as he felt able to dispose of Burford's application without having to do so. He did, however, provide helpful guidance and reminders as to when a *Norwich Pharmacal* order ought to be made. In his judgment, some of the previous decisions had suggested a number of pre-requisites that a claimant had to establish before the Court could then exercise its discretion. Andrew Baker J felt that a simpler, unified approach was to be preferred. The learned judge noted that the essential purpose of making an order for disclosure was to do justice. The only pre-requisite which a claimant had to establish was that the defendant had been 'mixed up' in the alleged wrongdoing, to the extent of having 'facilitated' it – something that does not require the defendant to have been complicit in the unlawful actions. Once a claimant has shown such involvement by the defendant, the only question remaining for the Court is:

"... whether justice requires that the defendant provide the assistance that the relief sought would compel him to provide, to further the end of righting a facilitated wrong."

Andrew Baker J did not consider that one should treat the strength of the claimant's case as a pre-requisite, or impose a threshold on how strong that case had to be before the *Norwich Pharmacal* jurisdiction became available – although that remained a key consideration (and one which would ultimately prove fatal for Burford's case). Rather, the learned judge preferred to consider all relevant factors in the round, which he described as follows (drawn from prior authorities):

- (i) the strength of the claimant's case that there had been wrongdoing against it (subject to the potential need to show that this case involved a direct cause of action for the claimant, which the learned judge left open);
- (ii) the strong public interest in allowing the claimant to vindicate his legal rights (or, by way of comment, giving the claimant the necessary information to decide whether to vindicate such right);
- (iii) the deterrent effect that an order for disclosure might have;
- (iv) whether the claimant could obtain the information sought by other means;
- (v) any knowledge on the part of the defendant that he was facilitating wrongdoing, or the defendant himself being a joint wrongdoer;
- (vi) whether an order might reveal the identity of innocent parties, who might suffer harm as a result;
- (vii) whether the information sought was confidential (the judgment referred to a 'degree' of confidentiality – but information tends to be either confidential, or not);
- (viii) any relevant privacy rights arising under Article 8 of the European Convention of Human Rights of those individuals whose identities would be disclosed pursuant to the order;
- (ix) any relevant rights by those individuals under data protection laws; and
- (x) again if relevant, the public interest in preserving the confidentiality of journalistic sources.

Andrew Baker J identified two further factors that arose based on the particular facts of Burford's case, namely:

- (xi) whether the order would interfere with, or even be required despite the existence of, the United Kingdom's regulatory regime for investigating; and
- (xii) the possible impact of the order on the United Kingdom as an equity trading venue.

Lies, damn lies and statistics

The judge considered whether Burford had a good arguable case that there had been market manipulation. By way of illustration of the issue at hand, he gave the simple example of two traders

who placed an order to sell shares for £10. The first trader withdraws the order when he decides that he cannot hope to obtain the price. The second withdraws the order with an intention to manipulate the market, by sending out a false signal. The first trader ought to be innocent of market abuse, while the second ought to be guilty, but both have sent the same objective signal to the market – a sell order for £10. That is why the Regulation requires a closer review of the purpose for which these orders were made, taking into account a range of factors and circumstances, to determine whether a trader acted for an unlawful purpose. While a detailed review of the Regulation and related pieces of legislation is beyond the scope of this article, it is worth noting (as Andrew Baker J did) that in order to establish market abuse through spoofing and layering under the Regulation, it is necessary to consider whether a trader placed orders “... *with no intention to execute*” them and then removed those orders for that same reason. In those circumstances, the trader would have sent a misleading signal to the market.

Andrew Baker J carefully reviewed Burford’s detailed expert evidence by which it sought to support its case that the fall in the share price was likely to have been caused by such spoofing and layering. A close, minute-by-minute review of the trades on 6 and 7 August 2019 showing a large volume of sell orders which were cancelled and then later replaced, as Burford had provided, could never establish whether any alleged unlawful conduct evidence by that trading activity had the effect of depressing Burford’s share price, because there was no control for comparison. Burford’s evidence therefore did not assist with assessing whether the Muddy Waters Tweets (which were not alleged to have been unlawful) could not by themselves have had the same effect on the share price. The learned judge further noted that finding a pattern of repeated placement, cancellation and replacement in trading data was not the same as finding *prima face* evidence of market manipulation, because:

“... the question remains one of intention to trade. For example, a trader wishing to sell off or reduce a long position, in response to the Muddy Waters tweets or simply in response to the price falling, might generate such a pattern as part of a best-execution strategy that aimed to maximise his average price traded while still selling the volume he wishes to sell.”

It was therefore quite conceivable that each placement could have been made with the intention of trading, each subsequent cancellation being a response to a lack of demand, and each newly replaced sell order being a further attempt to actually dispose of the shares held. Only a short seller could be accused of manipulating the market, but trading patterns did not throw any light on whether particular traders were in fact short sellers.

The LSE had provided its own evidence, preserving the anonymity of trades, to confirm that it had no cause to suspect unlawful behaviour or market manipulation and that the Burford sell orders under scrutiny were genuine. Both the LSE and the FCA had concluded that there was no market manipulation. The LSE’s witness pointed out that the anonymity of information that is publicly available limits the conclusions that can be drawn from it: public participants do not know the positions held by those placing orders, and may form the erroneous impression that something untoward has occurred. Andrew Baker J agreed with that sentiment, noting that the publicly available information, and the trends that Burford’s expert had identified, had led Burford to think of itself as a *Norwich Pharmacal* claimant. He noted that:

“Burford founds its case that there was or may have been market manipulation on statistics, and its undoing is the truth in the old adage that there are ‘lies, damned lies, and statistics’. That truth is not that one cannot trust carefully defined, accurately calculated statistical propositions, but that any truth illuminated by a correctly calculated statistical proposition is strictly confined by a careful definition of what has been calculated.”

The learned judge had some sympathy with the fact that the anonymised data did not allow Burford and its expert team to rule out any wrongdoing independently of the LSE and the FCA. Ultimately, however, the claimant's unwillingness to accept the conclusions of the LSE and the FCA was not a reason for granting the wide-ranging *Norwich Pharmacal* relief sought. Andrew Baker J concluded that the evidence of spoofing or layering was speculative at best, and it could not be said that Burford's case was capable of serious argument. Adopting the approach in previous authorities, that was sufficient to dismiss the Burford's application.

Andrew Baker J nonetheless went on to consider the other factors, as identified above, to see whether justice would in the round have required the LSE to provide assistance to Burford. As part of that exercise, the judge reviewed a range of potential causes of action that Burford might have had if evidence of wrongdoing were to be uncovered, to be able to vindicate its legal rights through the Courts. The judge considered whether Burford could in principle bring a tortious claim against Muddy Waters alleging a conspiracy with others to cause harm to Burford through market manipulation. In such a claim, Burford might press for the disclosure of the identities of the co-conspirators, which (if there were any) would be known to Muddy Waters. The LSE might also be called upon to provide further information to assist Burford with that claim – but *Norwich Pharmacal* relief was premature as no such claim had been brought. The judge also noted that the suggestion of an unlawful combination to injure Burford through (co-ordinated) market manipulation was as speculative as the suggestion that there was any market manipulation (co-ordinated or not) in the first place. Finally, any conspirators would have acted with a view to profiting at the expense of other investors, but not with the aim of injuring Burford as the company: even if such tortfeasors had foreseen some potentially harmful consequences to Burford, that would not have given Burford a right to sue as the victim of the conspiracy (following *Emerald Supplies Ltd v British Airways plc* [2015] EWCA Civ 1024). Having dismissed potential tort claims such as deceit or malicious falsehood, the judge concluded that Burford could only vindicate its right if a breach of the Regulation conferred on Burford private law rights – by creating a so-called 'Euro-tort' based on EU legislation. Again, Andrew Baker thought that this had not been clearly established. The judge also noted that the FCA's exclusive jurisdiction to investigate market abuse under the Financial Services and Markets Act 2000 meant that Burford could not easily (or at all) bring a private prosecution. In any event, in any private prosecution, Burford would have to bring a charge based on facts that had already been investigated by the FCA as the competent public investigate and prosecutorial body. Those were not circumstances to bring the *Norwich Pharmacal* jurisdiction into play, and neither did justice demand that Burford be assisted in a judicial review of the conclusions that the FCA had already reached.

Two further factors did not materially add to the scales on either side. Firstly, the judge thought that an order would be unlikely to have a deterrent effect - though ordering disclosure where both the LSE and the FCA had previously concluded that there was nothing untoward might throw some doubt on the competence of those entities, and could perhaps even encourage those willing to manipulate the market because the regulatory regime might appear to be ineffective. Secondly, Burford could not say the information was only available from the LSE, while the LSE could not easily point to another alternative source: that was because the FCA might have to disclose some of the information sought if Burford commenced judicial review proceedings, in order to challenge the FCA's findings.

Turning to the collateral damages that would be caused by any order revealing the identities of the traders responsible for the 360,000 share order events, Andrew Baker J found that this factor militated against the grant of relief. He found that:

“It is a significant and important feature of the AIM market, as operated by the Stock Exchange and regulated by the FCA, that generally trading activity is anonymous. Providing Participant Identity details in this case to a third party other than as part of the regulatory regime would be a serious invasion into the confidential and commercially sensitive trading activities and strategies of, it could be, a large number of entirely innocent parties.”

The judge also considered that while the LSE might have overstated the potential detrimental impact of any order on ‘UK plc’ and the United Kingdom as a major equity trading venue, the Commercial Court should not be seen to be trigger happy to intervene where regulatory and supervisory bodies had already investigated the matter – unless there were a clear-cut case that something had indeed slipped through the regulatory cracks. This was not such a case, for the reasons canvassed above.

Conclusion

The case illustrates that while the *Norwich Pharmacal* jurisdiction can be relied on where justice so demands, even though it may put those who have become mixed-up in wrongdoing to some potentially substantial time and trouble in providing information. However, it will not assist speculative attempts to establish whether a tort or crime might have been committed. That seems to be the right balance.