Regulating Market Manipulation in Australia

Honours Dissertation

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To the best of my knowledge and belief, this
this dissertation contains no material
previously published or written by another
person except when due reference is made
in the text of the dissertation.

12/10/92.

Monique Susan England

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INTRODUCTION

"Manipulation strikes at the heart of the pricing process on which all investors rely. It attacks the very foundation and integrity of the free market system."[1]

It is an offence under the Corporations Law[2] to manipulate the market for a security of a listed company. Yet in Australia to date there has been a noticeable lack of successful prosecutions. This dearth of prosecutorial activity cannot be attributed to a lack of manipulative trading, given that in 1974 the Rae Report[3] revealed various classical manipulative schemes as rife in the Australian securities industry. The probability is that the anti-manipulation legislative provisions are not being adequately enforced. As long as this situation is allowed to continue, market manipulation, with its ability to subject the free market forces of supply and demand to artificial stimuli, will remain a very real threat to the integrity of the Australian securities market, making a mockery of the assertion that the market is fair. The aim of this thesis, therefore, is to determine the social objectives sought to be met by the regulation of market manipulation, and how best to achieve them. A regulatory solution is sought to the problem of market manipulation which will ultimately serve to inspire much-needed confidence in the integrity of stockmarket trading in this country.

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1 *Pagel Inc* (1985) 48 SEC 223 at 231.

2 *Corporations Act 1989*, (Corporations Law) ss997,998.

3 Senate Select Committee on Securities and Exchange, *Australian Securities Markets and their Regulation*, 1974 vol 1, Parliamentary Paper no 98/74 (Rae Report) p1.

PART I: MARKET MANIPULATION AND ITS REGULATION - BACKGROUND AND RATIONALE

Chapter 1. MARKET MANIPULATION

1.1. Differentiating between manipulative and non-manipulative market conduct

Market manipulation has been described in general terms as any "intentional interference with the free forces of supply and demand".[4] It denotes "intentional conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities",[5] distorting the character of the market and rendering it "a stage-managed performance."[6]

Market manipulation is essentially trading activity which does not reflect a genuine intention to invest. Instead it seeks to induce the market to act in a particular way. In this sense, it must be distinguished from trading in the mere hope that prices will rise and a profit will be made: "Hope, belief, and motive are not purpose ... ".[7] All trading activity has some impact on the market, and there is nothing illegal per se about trading in the knowledge that share prices will be affected, as long as the

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4 *Pagel v SEC* 803 F 2d 942 (8th Cir 1986).

5 *Ernst v Hochfeld* (1976) 425 US 185 at 199.

6 *Re Halsey, Stuart & Co* (1949) 30 SEC 106 at 112.

7 At p124 - although the Securities and Exchange Commission (SEC) then states that purpose may be inferred where the hope, belief and motive are combined with "activity objectively resulting in market support".

trade is ultimately motivated by genuine investment purposes. As Mason J stated in *North v Marra*:[8]

> Purchases or sales are often made for indirect or collateral motives in circumstances where the transactions will, to the knowledge of the participants, have an effect on the market for, or the price of, shares. Plainly enough it is not the object of the section to outlaw all such transactions.[9]

Market manipulation differs in that active steps are taken to ensure that prices do in fact go up, down, remain stable, or react in any way that is contrary to a freely constituted market, on which investors are entitled to rely. Here, the market no longer reflects genuine forces of supply and demand. It is transactions such as these, engaged in with the intention of creating a false impression of genuine demand in the mind of the investing public, which are sought to be excluded by the regulation of market manipulation. After all, when investors see activity in the market:

> they are entitled to assume that it is real activity. They are also entitled to assume that the prices they pay and receive are determined by the unimpeded interaction of real supply and real demand ... Manipulators frustrate these expectations. They substitute fiction for fact.[10]

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8 *North v Marra Developments Ltd* (1982) 56 ALJR 106.

9 At p112.

10 *Edward J Mawod & Co* (1977) 46 SEC 865 at 871-872.

1.2. Manipulative practices

1.2.1. Artificial trades

The most common manipulative practice has historically been that of 'share ramping'. There, the price of a security is artificially stimulated, sending deceptively positive signals to the market of widespread investor interest. In 1892, a scheme of this kind was revealed in *Scott v Brown.*[11] Shares were bought at a price above the issue price in order to induce the public to subscribe for the shares. The object of the scheme was to deceive the public into believing that the artificial price so created represented genuine market demand. The scheme was therefore held to be illegal.

The aim of share ramping is essentially to boost reported share turnover and price. To this end, it is often accompanied by false transactions such as wash sales and matched orders, which have the effect of creating an appearance of active trading. A wash sale transaction involves no change in the beneficial ownership of the securities. Wash sales were part of the scheme of market manipulation revealed in the Australian case of *Moage.*[12] The defendant, Miles, pleaded guilty in the A.C.T. Magistrates Court to falsely trading in options of mineral exploration company, Moage, in order to boost the share price from one cent to nine cents over a five day

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11 *Scott v Brown, Doering, Mc Nab & Co* [1892] 2QB 724.

12 *Aust Financial Review* 2 August 1990, 20.

period in June 1990. His placing of orders with various brokers under fictitious names, meant that he was acting as both buyer and seller of the shares, ramping the market through a series of buy orders at increasing prices, and selling the shares in the rising market he had created.

Similarly, a matched order involves the placing of an order, either to buy or sell a security, in the knowledge that a contemporaneous order to sell or purchase the same number of shares at substantially[13] the same price has also been placed. The Rae Report noted with concern the fraudulent nature of such devices "designed to stimulate artificially market turnover and share prices for the purpose of profiting, at the general public's expense, from the distortion inflicted on the market."[14]

1.2.2. Actual trades

It is not only deceptive transactions such as those described above, which may fall foul of the prohibition against manipulative practices. Actual trading with the intention to manipulate the market can equally constitute an offence.

> A manipulation may be accomplished without wash sales, matched orders, or other fictitious devices. Actual buying with the design to create activity, prevent price falls or raise prices for the purpose of inducing others to buy is to distort the character of the market as a reflection of the combined judgments of buyers and sellers and to make of it a stage-managed performance.[15]

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13 For discussion of 'matched order' drafting anomaly in s998(5) see para 4.2.

14 Rae Report p207.

15 *Halsey's* Case at 112.

As with fictitious trades, the manipulator's design is to interfere with the free interaction of supply and demand forces, distorting the market in order to serve their own ends. In the US case of *ZICO*,[16] a series of sales were made by the offeror company in the shares of the target company, driving its share price down in order to make the takeover offer appear more valuable in the eyes of its shareholders.

The Australian case of *North v Marra*,[17] also in the context of a takeover, involved a scheme to reduce the defendant company's vulnerability to takeover. To this end, the company entered an agreement with broking firm, Norths, to establish a market for Marra shares at a certain level, in order to bring its share price closer to its asset backing. In delivering the majority judgment, Mason J said that the notions of genuine supply and demand on which the market is based, exclude transactions of this kind "undertaken for the sole or primary purpose of setting or maintaining the market price."[18]

In all cases of manipulative activity, whether fictitious or not, the danger is that the market, "in the absence of any disclosure that a market support operation is on foot, appears to be real or genuine, there being no overt sign of market support or manipulation."[19]

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16 *SEC v ZICO Investment Holdings Inc*87 Civ 8487 (TPG) (SDNY 2 Dec 1987(Lit Rel No 11617.

17 As above, fn 8.

18 At p112.

19 As above.

Chapter 2. SHOULD MARKET MANIPULATION BE REGULATED?

2.1. Market regulation: the dual goals of efficiency and fairness

"Under conditions of perfect competition, market behaviour is efficient. If the conditions of perfect competition are not satisfied, rational utility maximization may lead to stable suboptimal equilibria."[20]

Perfect competition has been defined as an absence of monopoly and the existence of complete knowledge.[21] However, inequalities of bargaining power and information distribution in the market lead inevitably to a degree of market failure. In particular, market manipulation creates an unfair advantage for the market rigger who, from a position of better information, is able to unfairly manipulate demand and supply. It is the aim of regulation therefore to reduce the effects of these imperfections in the market and "to bridge the gap between the suboptimal equilibrium of interaction and the optimal equilibrium of perfect competition."[22]

Thus, from an economic perspective regulation may be required to redress imperfections in knowledge and competition in order to promote a more efficient allocation of resources in the market. At a more individual level market regulation may be desirable to achieve fairness by protecting investors from certain types of

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20 Coleman, *Markets, Morals and the Law* (Cambridge Uni Press, 1988) p253.

21 Demsetz, "Perfect Competition Regulation and the Stock Market" in Manne (ed), *Economic Policy and the Regulation of Corporate Securities* (American Enterprise Institute for Public Policy Research, 1969) p2.

22 Coleman, *Markets, Morals and the Law* p243.

unacceptable behaviour in the market which offend notions of equity. It is arguable that these equitable justifications for market regulation are also a necessary condition for market efficiency, enhancing public confidence in the integrity of the market, and so contributing to the broader economic well-being:[23] "The system could not operate effectively, let alone efficiently, unless investors at large had confidence ... in the overall stability of financial markets."[24]

2.2. Anti-regulation: An efficiency view

There are those who maintain, however, that the market itself is essentially efficient, and that market forces of supply and demand will of themselves even out anomalies and imperfections in the market, rendering the need for regulation obsolete. Fischel argues that market manipulation is conceptually ambiguous and objectively cannot be distinguished sufficiently from legitimate trading activity to justify its regulation.[25] He considers the costs of enforcement and inherent uncertainty as to what actually constitutes manipulative conduct far outweigh any minimal harm suffered by the market as a result of the conduct. Fischel concludes that it is therefore preferable to allow the market itself to absorb and even out the effects of manipulative conduct.

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23 Friend, "The SEC and the Economic Performance of Securities Markets" in Manne (ed), *Economic Policy and the Regulation of Corporate Securities* pp186, 187.
Meyer states that the regulatory objectives of fairness and efficiency are "not inconsistent" and that the "maintenance of investor confidence in the market is essential to the continued flow of capital into the market." Meyer, "Fraud and Manipulation in Securities Markets: A Critical Analysis of Sections 123 to 127 of the Securities Industry Codes" (1986) 4 *C&SLJ* 92 at 103.

24 *Final Report of the Committee of Inquiry into the Australian Financial System* (AGPS Canberra, 1981) Campbell Report para 18.10.

25 Fischel and Ross, "Should the Law Prohibit Manipulation in Financial Markets?" (1991) 105 *Harv LR* 503 at 553.

However, in so concluding, Fischel limits his assessment to the purely economic consequences of market manipulation. The law is ultimately concerned with more than just market efficiency, incorporating rather "the multiple courses of human behaviour".[26] Consequently, the need to protect investors from the unfairness and deception of market manipulation should not be overlooked when balancing the comparative costs and benefits of its regulation.

2.3. Conclusion

Market manipulation, in creating the impression that an artificially created price in fact reflects the free and unimpeded flow of market supply and demand forces, perpetrates a fraud on all investors who are entitled to rely on the appearance of a true market, and is wholly inconsistent with notions of fairness underpinning the market. The protection of investors against the inequity of market manipulation and the maintenance of an honest market place are indeed "important public objectives that an unregulated marketplace cannot provide."[27] Moreover, from an economic perspective, the practice of market manipulation interferes with the efficiency of the market, which relies on prices being determined by supply and demand conditions, accurately reflecting risk and return relativities of listed stock.

Effective regulation of market manipulation is essential therefore, to ensure the public confidence in the fairness of the marketplace so integral to its continued survival.

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26 Manning, "Discussion and Comments" in Manne (ed), *Economic Policy and the Regulation of Corporate Securities* p84.

27 Breyer, "Analysing Regulatory Failure: Mismatches, Less Restrictive Alternatives and Reforms" (1979) 92 *Harv LR* 547 at 552.

Chapter 3: AN HISTORICAL PERSPECTIVE

3.1. Introduction

Market manipulation has probably existed as long as securities markets. Indeed it has been estimated that in 1903 approximately one third of all trading on the New York Stock Exchange represented manipulative trading activity.[28]

3.2. The common law

Even before legislation was enacted specifically to deal with manipulation in securities markets, courts sought to overcome the problem by the application of the common law, and the principle that a "natural market should not be tampered with."[29] In 1814, Lord Ellenborough in the case of *Rex v De_Berenger*[30] said of a conspiracy to raise the price of public government funds by false rumours:

> The purpose itself is mischievous, it strikes at the price of a vendible commodity in the market, and if it gives it a fictitious price ... it is a fraud levelled against all the public, for it is against all such as may possibly have anything to do with the funds on that particular day.[31]

Then in 1892, in a case of manipulation by trading alone, Lord Justice Lopes stated that there is "no substantial distinction between false rumours and false and fictitious acts": *Scott v Brown*.[32] It was held that trading at a premium in order to

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28 Loss, *Securities Regulation* vol 3 (Little, Brown: Boston, 2nd ed 1961) p1529.
29 At p1532.
30 3 Maule & S 6 at p72-73, 105 Eng Reprint (KB 1814) 536.
31 At p538.
32 [1892] 2QB 724 at 730.

mislead the market and induce public buying, amounted to a "criminal conspiracy to defraud the public".[33] A similar approach was adopted in the case of *United States v Brown*.[34] There, a manipulative course of trading involved the opening of 91 accounts with 52 brokers in order to 'wash' stock amongst the accounts at constantly rising prices. Judge Woolsey condemned manipulative trading as a fraudulent interference with a free and open market:

> When an outsider, a member of the public, reads the price quotations of a stock listed on an exchange, he is justified in supposing that the quoted price is an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length in a free and open market on the exchange.[35]

3.3. The development of a statutory offence

3.3.1. The United States

The provisions of the US *Securities and Exchange Act* of 1934 sought to clarify and give legislative force to these common law principles, protecting the integrity of the marketplace and ensuring that "prices [were] established by the free and honest balancing of investment supply with investment demand".[36] To this end, market manipulation was expressly prohibited as an "inequitable and unfair practice" posing a substantial threat to "the true functioning of the exchanges, upon which the economic well-being of the whole country depends."[37]

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33 Loss, *Securities Regulation* at 1533.
34 5 F Supp 81 (SDNY 1933).
35 At p85.
36 HR Rep No 1383, 73rd Cong 2d Sess (1934) at 10.
37 At p11.

Section 9(a)(1) specifically prohibits the entering into of wash sale and matched order transactions for the purpose of creating a false or misleading appearance of active trading, or with respect to the market of a security. Section 9(a)(1) is complemented by a more general prohibition in s9(a)(2). Section 9(a)(2) makes it unlawful to effect a series of transactions creating actual or apparent trading in a security, or raising or depressing the price of a security, for the purpose of inducing the purchase or sale of such securities by others. Section 9(a)(2) has been termed by the Securities and Exchange Commission (SEC), "the very heart of the Act" and is expressed in general terms in order to outlaw all devices used to persuade the public that trading activity on the exchange reflects genuine demand when it does not.[38] In addition, s 10(b) of the *Exchange Act* and rule 10b-5 thereunder act as a further anti-fraud restriction, prohibiting the use of 'any device, scheme or artifice to defraud' in connection with the purchase or sale of a security.

3.3.2. Australia

Similar provisions were not introduced in Australia until more than forty years later.[39] Prior to this, Australian securities regulation had been primarily influenced by the essentially non-interventionist approach of the United Kingdom, with its strong tradition of self regulation within the financial institutions of the City of London.[40]

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38 Loss, *Securities Regulation* p1549.

39 Ss 123, 124 *Securities Industry Act* 1980 (Cth), now ss997, 998 Corporations Law (although some States enacted securities legislation earlier eg s70 *Securities Act* 1970 (NSW), upon which the case of *North v Marra* was based).

40 Indeed, the UK continued to rely on the common law in regulating market manipulation until as recently as 1986 when s47(2) *Financial Services Industry Act* was introduced.

However, the sheer distances involved in the Australian securities industry and the spread of its financial centres, contrast sharply with the highly concentrated UK market centred in the City of London. Australian markets have proved far less susceptible, therefore, to a UK-based system of control solely by self regulation.[41] With the mining boom of the late 1960s and early 1970s came the recognition that existing regulatory mechanisms were failing to address those abuses prevalent in the market,[42] revealing the need for specific securities legislation along United States lines. Whether the legislative provisions so enacted have actually proved effective in controlling manipulative practices in this country is doubtful, as this thesis reveals.

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41 Indeed, stock market enforcement by self regulation alone has now been similarly rejected in the UK with the introduction of the *Financial Services Industry Act*. For discussion of the drawbacks of market control by self-regulation see fn 80.

42 As revealed by the Rae Report.

PART II: THE OFFENCE OF MARKET MANIPULATION

Chapter 4. THE AUSTRALIAN STATUTORY POSITION

4.1. Introduction

Market manipulation, false trading and market rigging are prohibited by s997 and s998 of the Corporations Law (previously s123 and s124 *Securities Industry Act* 1980).

4.2. Section 997: Market manipulation

Section 997[43] targets any activity which affects the price of securities for the purpose of inducing others to trade in those securities. It prohibits the engaging in of two or more transactions[44] in a particular security which have, or are likely to have, the effect of raising,[45] lowering,[46] maintaining or stabilising[47] the price of those securities. Further, an intention is required to induce other persons to sell, buy or subscribe for the securities of the corporation; intention which is at odds with general market behaviour. An example is the practice of share ramping. There, a purchaser enters transactions likely to cause the price of the particular

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43 Based on s9(a)(2) *Securities and Exchange Act* (US) 1934 - see above para 3.3.1.

44 'Transaction' is defined to include the making of an invitation to buy or sell securities: s997(10).

45 s997(1).

46 s997(4).

47 s997(7).

securities to increase, with the object of inducing others to buy. This purpose is clearly at variance with the expected aim of a purchaser which is to induce others to sell. Share ramping therefore is a practice prohibited by s997.

That two or more transactions must be engaged in to constitute a breach of this section appears illogical. One transaction with manipulative intent is "just as objectionable"[48] as two, and should thus fall within the prohibition.

4.3. Section 998: False trading and market rigging

Section 998[49] prohibits false trading and market rigging. In particular 'wash sales' and 'matched orders' are specifically prohibited. Section 998(1) makes it an offence to create or do anything which is intended or likely to create a false or misleading appearance of active trading in securities. The inclusion of the words 'or likely to create' in the prohibition of s998(1) may impose an objective standard, regardless of intention or even knowledge. In *North v Marra*,[50] Mason J interpreted the equivalent provision[51] narrowly, stating that the word 'calculated' in the section meant designed or intended, rather than adapted or suited.[52] Although the word 'calculated' is absent from the current prohibition, it is likely that a restrictive interpretation would similarly be imposed. It is in my view unlikely that

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48 Meyer, "Fraud and Manipulation in Securities Markets" (1986) 4 *C&SLJ* 92 at 103..

49 Based on s9(a)(1) *Securities and Exchange Act* (US) 1934 - above para 3.3.1.

50 As above, fn 8.

51 s70 *Securities Industry Act* (NSW) 1970.

52 *North's* Case at p112.

a court interpreting s998(1) would exclude consideration of intention altogether given the absence of a defence.[53]

In addition, s998(5) deems wash sale[54] and matched order[55] transactions to create a false or misleading appearance of active trading within the meaning of s998(1), and as such, they are specifically prohibited. A drafting anomaly apparent in the legislative definition of matched order transactions in ss998(5)(b), (c) requires that the orders are for the same or substantially the same number of securities at substantially the same price. Are orders placed at the same price excluded from the prohibition? This result seems illogical, and yet a literal reading of the section can produce no other.

However, s998(1) extends beyond wash sales and matched orders, making it an offence to create a false or misleading appearance with respect to the market for, or price of, any securities. An example is the case of *North v Marra*,[56] in which a scheme of trading was engaged in to artificially set the market price of Marra shares at a certain level. Shares were bought on the exchange for higher than market prices in order to make the shares appear strong in the context of a takeover bid for the company. The scheme was held to be illegal; the primary purpose of the transactions being that of "setting or maintaining the market price."[57]

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53 This argument is supported by the prohibition against wash sales and matched orders under the deeming provision of s998(5). The apparently objective prohibition so created is qualified by the inclusion of a specific defence in s998(6) focusing on the purpose underlying the relevant trading activity. In this way, at least some element of intention is retained.

54 s998(5)(a).

55 ss998(5)(b), (c).

56 As above, fn 8.

57 At p112, per Mason J.

Where a matched order or wash sale transaction is deemed by s998(5) to be in breach of s998(1), a defence is available if it can be shown that the creation of a false or misleading appearance of active trading in securities was not one of the purposes of the transaction: s998(6). However, where a breach of s998(1) is alleged, independently of the deeming provision s998(5), then no defence is available. The purpose of a limited defence of this kind is to avoid contraventions of s998(1) without intent, by the mere act of engaging in a wash sale or matched order.[58]

In addition, s998(3) prohibits the use of fictitious devices and transactions not involving a change in beneficial ownership to raise, lower, or maintain the price of securities, or cause it to fluctuate. Where the transaction does not involve a change in beneficial ownership (wash sale), a defence is available if it can be shown that it was not a purpose of the transaction to create a false or misleading appearance with respect to the market for, or price of, the securities: s998(8).

It appears, therefore, that a wash sale within the meaning of s998(3) would also be deemed to contravene s998(1), falling within the deeming provision of s998(5). However, despite the identical nature of the conduct involved in each offence, the parameters of the respective defences are quite different. In a s998(1) prosecution, the defence is expressed in terms of there having been no purpose to create a false or misleading appearance of active trading in securities: s998(6). Where a breach of s998(3) is alleged, however, the accused must show that it was not a purpose of the wash sale to create a false or misleading appearance with respect to the price of, or market for, the securities: s998(8).

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58 Hambrook, folio "Misconduct in Securities Dealings: Keeping the Ring" (1991) p6.

4.4. The complexity of the legislation - is it self defeating?

The overlap between s998(1) and s998(3) and their respective defences is only one example of the distinct lack of definition and clarity evident in the market manipulation provisions as a whole. It is not only between the subsections that such inconsistencies are apparent however. The sections themselves overlap significantly. Section 997 essentially targets 'real' trades engaged in for the purpose of inducing others to trade in the securities. Section 998 on the other hand, is aimed at artificial trading activity, in particular wash sales and matched orders, creating a false or misleading appearance with respect to the price of or market for securities. However, in *North v Marra* Mason J stated that real trades are just as capable of creating a false or misleading appearance of the market for or price of securities as fictitious trades,[59] and so would also fall within the operation of s998(1).

The degree of overlap and lack of clarity between the respective sections is complicated further by the complexity of the drafting. The offences (s998 in particular) appear to have been framed in a 'haphazard'[60] attempt to cater for the broad spectrum of manipulative possibilities; the desire for comprehensive coverage largely overriding the need for comprehension. Contrast the equivalent US provisions,[61] and indeed those of the Commonwealth *Corporate and Securities Industry Bill* of 1975,[62] which represent an earlier, and arguably more

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59 148 CLR 42 at 59. "Transactions which are *real* and genuine but only in the sense that they are intended to operate according to their terms, like fictitious or colourable transactions, are capable of creating quite a *false or misleading impression as to the market or the price*. This is because they would not have been entered into but for the object on the part of the buyer or of the seller of setting and maintaining the price".

60 Meyer, "Fraud and Manipulation in Securities Markets" (1986) 4 *C&SLJ* 92 at 98.

61 ss9(a)(1), (2) *Securities and Exchange Act* 1934 (US) above para 3.3.1.

62 Section 119 provides that a person shall not effect or take part in transactions in securities of a company having the effect of creating an appearance of active trading, or of raising, lowering or maintaining the price of the securities for the purpose of inducing others to sell, purchase or subscribe for securities.

straightforward, version of our current legislative provisions. There the prohibition against false trading in s120 is directed solely at wash sales and matched orders; the wider range of manipulative possibilities falling within the scope of the general market manipulation prohibition of s119.

Under the current Australian provisions, however, matched orders and wash sales are only some of the broad range of manipulative possibilities targeted by the false trading prohibition (s998), in addition to the general market manipulation prohibition contained in s997. Whilst the 1975 Bill and US legislation provide for a narrow, specific offence complemented by a more general prohibition, in Australia today the scope of the narrow offence (s998) has expanded to the extent that it operates concurrently with the general prohibition (s997).

In terms of complexity, therefore, sections 997 and 998 far surpass the US equivalents on which they were based, and yet have proved far less successful in their operation.[63] Indeed, it has been suggested that the complexities of the legislation are, in part, responsible for the lack of successful prosecutions in Australia to date.[64] However, poor drafting is just one of the many difficulties to be overcome in bringing a successful prosecution for conduct of this kind. The substantive elements of the offence itself must therefore be considered in this context.

Section 120 specifically prohibits the engaging in of wash sale and matched order transactions for the purpose of creating an appearance of active trading in the securities.

63 The anti-manipulation provisions in the US have proved "markedly effective", (Loss, *Securities Regulation* p1568) to the extent that the SEC has stated manipulation is no longer "an appreciable factor in our [US] markets." (1950) 16 SEC Am Rep 37.

64 Weinberg states that "the substantive law governing offences under corporations and securities law should be simplified" to enable "basic concepts of fraud and dishonesty" of this kind to be more readily understood. Weinberg "Complex Fraud Trials - Reducing their Length and Cost" (1992) 1 *JJA* no 3, 151 at 152.

Chapter 5: PROVING THE REQUISITE MANIPULATIVE INTENT

5.1. Introduction

The legislation focuses on the existence of the requisite manipulative intent as the cornerstone of each offence. Section 997 requires proof of an intention to induce others to trade, whereas s998 is expressed in terms of a purpose to create a false or misleading appearance of active trading in securities, or of the price or market for those securities.

However, intention is a highly subjective and difficult concept to identify with certainty as direct evidence by way of admission is rare.[65] Proof of the requisite manipulative intention with respect to particular trading activity must generally be established circumstantially, drawing inferences from the relevant conduct and from the surrounding facts and circumstances: "Since it is impossible to probe into the depths of a man's mind, it is necessary in the usual case (that is, absent admission) that the finding of manipulative purpose must be based on inferences drawn from circumstantial evidence."[66]

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65 Although, in the case of *Re Moyer* (1988) Admin Proc 3 - 6985, a co-conspirator testified that he and the defendant intended to manipulate the market (an admission of this kind is rare).

66 *Re Federal Corp* (1947) 25 SEC 227 at 230.

5.2. Inferring manipulative intent

The process of proving intention circumstantially is complex, and often involves drawing inferences from a mass of factual data, in order to support a conclusion of manipulative purpose on the facts:

> Findings must be gleaned from patterns of behaviour, from apparent irregularities, and from trading data. When all of these are considered together, they can emerge as ingredients in a manipulative scheme designed to tamper with free market forces.[67]

To simplify the task of inference derivation, courts in the US have formulated a standard approach to circumstantial evidence of intention as a starting point for assessing possible breaches. The general rule is that a prima facie case of manipulative purpose can be made out where a person who has a "substantial, direct pecuniary interest in the success of a proposed offering takes active steps to effect a rise in the market"[68] of that security.

Accordingly an inference of manipulative purpose is generally viewed as justified where a pattern of trading behaviour is supported by evidence of a motive, such that manipulative purpose can be reasonably inferred as a result. In determining the relevant intention circumstantially, it is thus necessary to assess the relevant trading activity in the light of the surrounding facts and circumstances, and any motivating factors.[69]

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67 *Re Pagel Inc* [1985-86 Transf binder] (CCH, 1 Aug 1985) 83, 909 at 87, 751.

68 *Crane Company v Westinghouse Air Brake Company* (1969) 419 F 2d 787 at 795.

69 For example, a takeover situation may give a director in the offeror company an interest in the shares of the target company being traded at a lower price in order to make the takeover offer appear more attractive. *ZICO*. Alternatively, the offeror company may have an interest in ensuring that its own shares are traded at a high price during the offer period in order to make its shares attractive to shareholders of the target company - such a motive was alleged in the case of *Tuckwell* discussed below. A takeover offer may also give the target company an interest in ensuring that its shares are traded at a high price in order to resist the takeover: *North v Marra*.

5.3. Proving manipulative intent

Although evidence of motive and unusual trading activity can lead to an inference of manipulative purpose, it is an inference only. Ultimately, it is for the court to decide whether the charge of market manipulation has, in fact, been established beyond reasonable doubt in all the circumstances presented before it.

Circumstantial evidence of intention can only ever result in an objective interpretation of the facts leading to a hypothesis of manipulative conduct. This hypothesis must then be tested in the light of any alternative explanation of legitimate trading activity on the part of the accused. The presence of an arguably legitimate basis for the market conduct in question, will be sufficient to raise doubts as to the existence of manipulative purpose on the facts, negating a finding of manipulative conduct. The difficulties inherent in establishing the requisite manipulative intention circumstantially, are thus revealed. Although the evidence might objectively lead to an inference of manipulative conduct, commercial justification and legitimate trading purposes can readily be asserted, rendering the offence of market manipulation by its very nature elusive.[70]

5.4. Case study: *Tuckwell*

The elusiveness of the offence was demonstrated by the recent case of *Tuckwell*,[71] in which the inferential process of reasoning was relied upon to assert a charge of market manipulation. This was the first criminal prosecution to go to trial in

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70 *US v Mulheren* 938 F 2d 364 (2d Cir 1991).

71 Prosecution in the South Australian Central District Criminal Court March/April 1992, acquittal April 8, 1992.

Australia for the offence of market manipulation,[72] and the practical implications of prosecuting a perceived breach of the market manipulation provisions were brought sharply into focus. The case clearly illustrates the difficulties of establishing the requisite manipulative intention in respect of a course of trading which, viewed objectively, and in the context of apparent motivating factors, appeared to be manipulative, and yet ultimately led to an acquittal.

5.4.1. The charge

Tuckwell was charged with market rigging in breach of s124 of the *Securities Industry* (SA) *Code*. It was alleged that in November and December of 1990, Tuckwell engaged in trading activity calculated to create a false or misleading appearance with respect to the price of securities in Intrepid Oil NL of which he was chairman.

5.4.2. The circumstantial case

A suspicious pattern of stock exchange transactions during the relevant period, as detected by the Australian Stock Exchange (ASX) Market Surveillance Division and investigated by the Australian Securities Commission (ASC), formed the basis of the Crown's circumstantial case. The prosecution alleged that the sequence of transactions, their timing and pattern were such that only one reasonable explanation could be inferred; that of manipulation to maintain a market price for Intrepid shares.

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[72] In the *Moage* prosecution the defendant Miles pleaded guilty and the principal authority in the area, *North v Marra*, was a civil matter.

The circumstantial case was strengthened by the announcement by Intrepid of a takeover bid for Pacarc Nuigini during the relevant period, providing evidence of a motive to manipulate the market. The market price of Intrepid seemed to be particularly significant in this context, as the takeover was a scrip offer of seven Intrepid shares for two Pacarc shares. It was thus alleged that the takeover, being a scrip offer in which share price would be a material factor, provided a motive for Tuckwell to keep the share price of Intrepid at a certain level in order to support the offer.

In establishing its circumstantial case, the prosecution identified a pattern of bids entered for the minimum parcel of 2,000 shares in the last seconds before the close of trading, raising the highest closing bid from five or six cents to seven and a half or eight cents. These bids would then be cancelled before the commencement of trading on the following day in each case. It was alleged that the purpose of these last minute bids was to effect the closing market, ensuring their inclusion in the financial press. An appearance of strength in the market for Intrepid shares would result, strength that was largely illusory given that the bid so entered would be cancelled in the pre-opening phase the next day. This technique of 'marking the close', was identified as a 'classic' type of manipulation commonly referred to in texts[73] and cases[74] overseas, reinforcing the inference that the conduct engaged in by Tuckwell was similarly for manipulative purposes.

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73 Cited for example in Sibears, "Securities Manipulation Outline and Case Study Materials" *SEC Enforcement Training* (Oct 1989) at 56 refers to the practice of 'marking the close'. Also Sjoblom, paper, "Primer: Investigating and Proving a Market Manipulation Case" (Washington,May 1989) 594.

74 An example is the case of *Walter T. Newman* SEC Exch Rel No 18932 (Aug 4, 1982) where a late bid was entered to reduce the margin account deficiency and so ensure a direct pecuniary benefit for the manipulator. Fictitious bids were placed near the close of trading so as to frequently cause the stock to close at a price higher than the prior sale price. Similarly, the case of *Re Moyer* (1988) Admin Proc No 3-6985, the quoted inside bid was raised at the close to send a positive signal to the market. The bid would then be dropped back at the opening of the market the next day.

In addition, actual trades for small parcels of shares were engaged in at various times during the relevant period. These trades were alleged to have been entered with the purpose of removing sellers at lower prices and causing closing trades to be recorded around eight cents, reinforcing the appearance of strength in the market.

Evidence led from prosecution witnesses as to the unusual character of such trading activity, strengthened the inference that a market support scheme was being implemented by Tuckwell, to create a false appearance of market strength with respect to Intrepid shares. In addition, the scrip offer for Pacarc provided an incentive for Tuckwell to prop up an otherwise declining market for Intrepid shares in the wake of unsuccessful well strikes by the company. The circumstantial evidence thus objectively appeared to provide both a trading pattern and motive upon which to base an inference of manipulative purpose.

5.4.3. The verdict

Upon hearing the explanation of the accused in respect of the same objective set of circumstances described above, the jury returned a verdict of not guilty. How can evidence so strongly support an inference of manipulative intent and yet be equally open to explanation on grounds of legitimate trading activity? It is the role of the court to assess the circumstantial evidence of intention put forward by the prosecution in the light of the accused's explanation. Only then can it be decided whether the offence has been proved beyond reasonable doubt.

Tuckwell stated in his evidence that a director of a company should hold a reasonable financial stake as an indication of commitment to the company. This was his reason for buying Intrepid shares during the relevant period. As chairman of the board of Intrepid, he felt he should increase his stake in the company. However, he stated that he was buying at this time "despite the takeover, not because of it."[75] Tuckwell argued that, in the context of the takeover bid and the announcement of Intrepid well results, this was the only logical time for him to buy.[76]

Further, he stated that the pattern of cancelled bids for the minimum parcel at above market prices did not evince an intention to manipulate the share price of Intrepid, but was intended merely as a means of 'testing the market'. He explained that his aim was merely to send a signal to potential sellers, attracting them into the market with a view to subsequently buying larger parcels of shares: "That's what your illiquid shares are about. If you want the shares, you have to pay up."[77] Tuckwell's justification for cancelling the bids each morning was to avoid incurring brokerage fees for such a small trade, ensuring that it was a signal only. The intention was merely to present himself as a potential buyer at a certain price; "somebody sniffing around."[78]

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75 Transcript p1061.

76 Tuckwell explained that it may have been thought improper for him to buy in the weeks leading up to the drilling of the well, and similarly while the offer documents were in the hands of Pacarc shareholders.

77 Tuckwell in cross examination, transcript p1059.

78 Transcript p992.

In addition, he contended that the market price of Intrepid shares was not material to the success of the scrip offer, which depended rather on underlying values.[79] In this way, Tuckwell was able to raise doubts as to the existence of a motive and explained the transactions in such a way as to exclude a finding of manipulative intent.

5.5. Conclusion

The elusive nature of the offence of market manipulation is apparent. Even once a prima facie case is established, the difficulty of proving the requisite manipulative intention beyond reasonable doubt is often a major barrier to successful prosecution.

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79 The success of the takeover would essentially be determined by substantial shareholders of Pacarc aligned in influential groups. These major shareholders it was contended, would be less concerned with market price variations in illiquid speculative mining stock such as this, but would rely rather on underlying values.

Chapter 6. THE JURY TRIAL IN THE COMMERCIAL CONTEXT

6.1. Introduction

Related to the difficulty of proving intention beyond reasonable doubt in respect of complex market offences of this kind, is the question of the role of the jury trial, and indeed the criminal law in this context.

6.2. The jury - lacking the requisite business knowledge?

The jury has been targeted as unsuited to the commercial sphere, lacking the requisite business knowledge with which to assess the legitimacy or otherwise of particular trading activity. During preliminary argument, Tuckwell, who was unrepresented, stated that in his view such matters should rather be determined within the securities industry itself, by the ASX Disciplinary Board, for example.[80] He argued that a jury has, on the whole, little or no practical experience or knowledge of the complexities of the marketplace and the range of trading possibilities which abound within it.[81] By its very nature, therefore, the jury may

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80 Currently, members of the Australian Stock Exchange can be subject to ASX Disciplinary Proceedings where the ASX Articles of Association have been breached. In particular, article 52 prohibits engaging in conduct which is not efficient, honest or fair, or which is otherwise prejudicial to the interests of the exchange. Market manipulation is conduct which is inconsistent with the exchange's objective of ensuring the conduct of a fair, efficient and orderly stockmarket, (Rae Report p473) and would thus contravene article 52.
However, self-regulation of stock exchanges is not viewed with universal satisfaction: Grabosky and Braithwaite, *Of Manners Gentle* (Oxford Uni Press, Melbourne,1986) p15. It provides a more flexible form of enforcement, but lacks the concrete force of law. In addition there is always the risk of industry self interest in a system of internal control. Indeed, Weinberg states that "self regulation by the various stock exchanges [is] ... hopelessly inadequate, almost akin to non-regulation." Weinberg, "Complex Fraud Trials - Reducing their Length and Cost" (1992) 1 *JJA* no 3, 151 at 152.

81 Jurors are chosen at random in accordance with the *Juries Act* 1927 (SA) representing a cross section of community experience and views. Section 11 provides that all persons residing in SA who are enrolled to vote and not above the age of 70 are qualified and liable to serve as a juror unless excluded by the

be illequipped to determine whether or not a series of stock market transactions constitutes "acceptable" market behaviour.

Tuckwell is not alone in his criticism of the role of the jury in determining commercial illegality. Other commentators have expressed similar concern that "the task of the prosecution is unfairly weighted against it".[82] It is said that the difficulties of detection, obtaining the necessary evidence and proof inherent in cases of this kind are compounded further by the complexity of the evidence and problems of the jury in that "much of the evidence will frequently be beyond the jury's understanding".[83] An assessment of market behaviour as manipulative may require a fundamental grounding in the operation of securities markets in order to be able to distinguish prohibited conduct from the enormous range of diverse investment strategies which are in fact legitimate.

The 'select' jury - comprising a specialised panel of brokers, accountants or lawyers with the requisite degree of business knowledge and experience with which to assess market conduct - has been suggested as a means of overcoming these inherent shortfalls of jury knowledge and experience in the field.[84] However, this notion is itself fraught with difficulties, as questions of possible bias, self interest and insularity in such a specialised panel must inevitably be raised. The select jury

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Act. In particular, s13 provides for ineligibility on grounds of incapacity or exclusion under Sched 3. Schedule 3 essentially excludes those employed in a legal or political capacity.

82 Santow, "Regulating Corporate Misfeasance and Maintaining Honest Markets" (1977) 51 *ALJ* 541 at 543.

83 At p544.

84 For example in 1975, the Criminal Law and Penal Methods Reform Committee of SA recommended the introduction of a special jury system in recognition of the difficulties faced by unqualified jurors in understanding the complexity of the evidence and arguments - "The special jury which we envisage would consist ... of persons whose education or training in a particular field enabled them to follow evidence in certain cases better than those who had not received such education or training." p101.

has been criticised as "elitest and undemocratic".[85] Indeed, the whole purpose of the jury system is to provide a commonsense backup to a complex system of law; a representative section of the community deciding the issues of the case according to the standards of society as a whole. To replace the jury with a panel of experts would distort this vital link between the law and society, bringing only a limited and incomplete community perception to the vital issues of law involved.

The possibility of trial by judge alone has been raised in the UK in the wake of the complex *Blue Arrow* fraud case in which convictions for conspiracy to defraud were quashed following a twelve month trial. The judge labelled the case a "costly disaster and an ordeal for the jury".[86] In SA an accused person may elect to be tried without a jury,[87] but courts have expressed strong support for trial by jury nevertheless. Brennan J has emphasised the role of the jury as "the chief guardian of liberty under the law, and the community's guarantee of sound administration of justice."[88] Further, Douglas J of the US Supreme Court has stated that; "A jury reflects the attitudes and mores of the community from which it is drawn... Since it is of and from the community, it gives the law an acceptance which verdicts of Judges could not do."[89]

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85 Phillips, "Can the Jury Cope?" (1987) 61 ALJ 479, 481.

86 Hurst, "Setback for UK corporate watchdog" *Aust Financial Review* 30 July 1992, 3.

87 Section 7 *Juries Act* 1927(SA). Whether this option would be available in SA for a prosecution under the Corporations Law is doubtful. Although enacted as State legislation, the Corporations Law is "to have the characteristics of, and is to be treated, for all practical purposes within each jurisdiction as if it were, a Commonwealth rather than a State Law." Explanatory Memorandum to the *Corporations Legislation Amendment Bill* 1990 (AGPS) para 30.

88 *R v Brown* (1986) 19 A Crim R 136 at 152.

89 Phillips, "Can the Jury Cope?" (1987) 61 *ALJ* 479 at 482.

6.3. The jury as the cornerstone of criminal justice

Ultimately it is not the market "acceptability" of the trading activity which is called into question by the offence of market manipulation. Rather it is the relevant intention underlying the activity, which must be determined. It is the proper role of the common law jury to decide according to ordinary standards of commonsense and the judgment of the community, whether the requisite criminal intention has indeed been established beyond reasonable doubt. This premise is the very cornerstone of our system of criminal justice, and applies equally in respect of market offences as with all other serious criminal offences.

In *Chamberlain v The Queen* Deane J stated:

> Two relevant principles permeate the administration of justice in this country. The first is that no person should be adjudged guilty of a serious crime except by the verdict of a jury given upon the evidence given against him or her. The second is that no person should be found guilty of any crime unless the evidence adduced against him or her establishes his or her guilt beyond reasonable doubt.[90]

These principles have been undermined to a certain extent by the statutory imposition of pecuniary punishment for particular conduct, to be recovered by civil action,[91] and questions surrounding the proper role of the traditional criminal law approach in respect of white collar crime. However, to the extent that market manipulation remains a criminal offence, a court of law is indeed the appropriate forum for determining the legality or otherwise of market conduct. The principles

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90 *Chamberlain v The Queen* (1983-1984) (No 2) 153 CLR 521 at 617.

91 Such as under ss76, 77 *Trade Practices Act* 1974 (Cth).

of trial by jury and proof beyond reasonable doubt remain "of fundamental general importance to the protection of the ordinary citizen against injustice and tyranny"[92] in this context, as in any other. Rather than abandoning the jury system in the market context, attention should focus on addressing the difficulties of the length and complexity of the corporate law trial: "In jury trial brevity and simplicity are the hand-maidens of justice. Length and complexity its enemies."[93]

6.4. Taking the jury question further - the morality of market crime

Essentially it seems that the principal objection to the jury system in the market context centres on the failure of a jury to fully grasp the complexities of the market activity involved. It is perceived that this confusion, when combined with the apparently victimless nature of the crime alleged and the 'respectability' of the defendant,[94] may render the jury unwilling to infer the requisite manipulative intention. Indeed, the jury may be inclined to view the conduct, not as 'criminal' in the traditional sense, but as aggressive business activity, and one of the risks inherent in stock market investment generally.

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92 As above fn 90.

93 UK Court of Appeal in the *Blue Arrow* case. Kluver, "Corporate crime trials: the reform agenda" (1992) *BCLB* no. 19, 229.
In Australia the Standing Committee of Attorneys General (SCAG) resolved on 7 August 1992 to undertake review and implement reform initiatives to address evidentiary and procedural problems in the prosecution of complex fraud: "without significant intervention to modernise the rules of evidence and procedure, complex fraud offences will be untriable, and an unequal or dual system of justice will be seen to exist, favouring the major perpetrator of fraud over the minor offender where crime is easy to prove" Standing Committee of Attorneys-General, *Complex Fraud Trials* p1.

94 Santow, "Regulating Corporate Misfeasance and Maintaining Honest Markets" (1977) 51 *ALJ* 541 at 555.

However, the question of the jury's perception of manipulative trading activity extends beyond the role of the jury system in this context. Instead, it raises the far more fundamental issue of determining society's view of market manipulation and the implications of this for the regulation of the conduct. Ultimately it is the moral reprehensibility or otherwise of market manipulation which must be considered. Is behaviour of this kind sufficiently 'wrong' in the view of society that its perpetrators should be brought before the criminal courts of law? Or is it merely 'criminal', not in the traditional sense, but rather because government has statutorily categorised it as such? If this is so, and market manipulation in itself does not inspire widespread community condemnation, then perhaps there are other more appropriate avenues for dealing with this type of conduct.

Chapter 7. THE CRIMINALITY OF MARKET CRIME

7.1. Introduction

It is acknowledged that market manipulation is 'wrong'. The question remains how wrong is it, and what measures should be taken to control it? The current regulatory approach to the control of market manipulation is essentially criminal; legislatively prohibiting the conduct and imposing criminal sanctions in respect of the offences so created. However, the recent trend in corporate law towards greater reliance on civil sanctions, and the ASC's stated preference[95] for their speed and flexibility, highlight the need for a fundamental reassessment of the role of the criminal law in the regulation of market offences.

7.2. The morality of market crime

The failure of the offence of market manipulation to fit the traditional criminal model has been mentioned in the context of jury perceptions. There is an element of "moral neutrality"[96] in respect of economic crime which distinguishes it from other more traditional criminal categories, in which more readily appreciable harm is occasioned, provoking widespread community condemnation. Market crimes,

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95 "the Commission's preferred approach is to use civil process to restrain wrongdoing and recover the money that has been misappropriated:" Williams, Address to Business Law Education Forum (1991) *ASC Digest*, Rep Spch 37 at 43.
ASC chairman, Tony Hartnell is also reported as having outlined a "clear policy" of pursuing civil remedies to reduce investigation expenses and delays in getting to court: Spiers, "DPP accuses ASC of going soft on crime" *Aust Financial Review* 8 Sept 1992, 4.

96 Kadish, "Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations" (1963).30 *U Chi L Rev* 423 at 425-427.

on the other hand, are non-violent, often with remote and obscure harmful effects and no readily discernable victim.[97] In addition, the perpetrator is generally of respectable character and his conduct may appear more akin to "acceptable aggressive business behaviour"[98] than traditional notions of criminality.

It must be considered, therefore, whether criminal sanctions should be imposed in respect of activity of this kind to which "the stigma of moral reprehensibility [may] not naturally associate itself,[99] violating the legal but not the moral code. Indeed, the imposition of criminal sanctions in the absence of the requisite degree of moral reprehensibility may in fact prove to be self-defeating and highly unsuited to the social ends sought to be achieved. It has been stated in the context of insider trading, that the moral ambiguity regarding conduct of this kind, is at the heart of the failure in Australia to effectively sanction it by way of prosecution.[100] The same can equally be said of market manipulation. If society is uncomfortable with the categorisation of market offences as criminal, then the traditional criminal sanctions imposed by the legislation will not be effectively implemented in practice. To legislate for criminality in this way may thus result in a plethora of unused and perhaps even unusable statutory offences. This is illustrated by the virtual standstill currently facing the regulation of market manipulation in this country. Rather, a more flexible approach may be required, catering for the particular demands of market crime and ensuring its effective regulation.

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97 As above, fn 94..

98 As above, fn 96.

99 As above.

100 Vorreiter, "The Prosecution of Insider Traders" (1991/1992) 4 *Corp & Bus LJ*, no 2., 51.

On the other hand, there seems no justification for distinguishing between a blue collar thief and a white collar criminal, merely because the latter steals from a company or defrauds other investors through his conduct.[101] Both are equally objectionable.[102]

7.3. Distinguishing economic crime

On a practical level, however, it must ultimately be recognised that economic crime differs substantially from 'crime' in general, and that different ends are sought to be achieved by its regulation. Laws regulating economic crime are essentially founded upon the need "to protect the economic order of the community against harmful use by the individual of his property interest".[103] Moreover, the complexity of this type of offence may set it apart from more conventional crimes. As such, the traditional criminal law approach may be "too blunt an instrument for sophisticated economic crime",[104] in view of the particular problems posed by the criminal standard of proof and trial procedure in the commercial sphere. Elliston states that "business is too complex an activity, involving multiple factors and aspects, to treat by means of criminal laws with traditional sanctions".[105] Further,

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101 As above, fn 94.

102 Indeed, the cost to society of market fraud of this kind is substantial. At a cost of $6b to $13b annually it represents between 40% and 50% of the total costs of major categories of crime. Kluver, "Corporate crime trials: the reform agenda" (1992) *BCLB* no 19, 229. As regards the particular offence of market manipulation Dickens (previous senior director of National Corporations and Securities Commission (NCSC) Market Supervision Division) states that it is difficult to estimate a dollar value"...because the price is rigged and you cannot tell how many people made the wrong decision on the basis of manipulation. However, the damage to the integrity of the market can be significant and the number of people damaged can be quite high" Rowbotham, "Exchange Sleuths to Target Manipulation" *BRW* 25 Sept 1990, 40 at 41.

103 Kadish, "Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations" (1963) 30 *U Chi L Rev* 423 at 425.

104 Vorreiter, "The Prosecution of Insider Traders" (1991/1992) 4 *Corp & Bus LJ* no 2, 51 at 68: reference to Editorial Comment "Costing the Insider", (1988) 9 *The Company Lawyer* 38.

105 Elliston and Bowie, *Ethics, Public Policy and Criminal Justice*, (Oelgeschlager, Gunn & Hann; Cambridge, Mass, 1982) p67.

the criminal process, with its prohibitive costs and delays, heavily overlaid with procedural safeguards for the accused and strict burden of proof, is often criticised as being "too cumbersome and inefficient to attain the state's policy goals"[106] in respect of market offences.

It is appropriate at this point to consider what are these 'policy goals' sought to be attained by the regulation of manipulative conduct in the marketplace, and how best to achieve them.

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[106] Ball and Friedman, "The Use of Criminal Sanctions in the Enforcement of Economic Legislation: A Sociological View" (1965) 17 *Stan LR* 197 at 216, 214.

PART III: OVERCOMING REGULATORY FAILURE

Chapter 8. THE REGULATORY OBJECTIVES - WHY AREN'T THEY BEING MET?

8.1. Golden promise and harsh reality

In 1974 the Rae Committee reported that "securities markets will not, in the long run, develop or maintain any reasonable standards of efficiency... if those who run - and operate in - the market allow sharp and manipulative practices to develop and continue unchecked."[107]

The regulatory objectives sought to be achieved by the prohibitions against market manipulation and market rigging as set out in ss997 and 998 of the Corporations Law were originally stated in the House of Representatives on April 16, 1980. Before the House on that day, was the predecessor of Australia's current securities legislation, and of it was said: "It is the intention of the Bill before the House to overcome abuses which the Committee shows applied in the securities market."[108] Further, it was stated that the main purpose of the Bill was "to provide maximum efficiency within the marketplace and to protect the investor."[109]

Twelve years later, it is clear that the regulatory scheme implemented in 1980 has fallen well short of its intended objectives. The abuses identified by the Rae

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[107] Rae Report, vol.1 at p472.
[108] Aust, Parl, *Debates*, (1980) p1801.
[109] Aust, Parl, *Debates*, (1980) p1815.

Committee continue to plague our markets,[110] and there remains a distinct lack of public confidence in investment in the Australian corporate sector, both at home and abroad. Australia's relatively low participation rate in securities markets compares poorly with that of other developed countries,[111] and may reflect a lack of investor confidence in the integrity of Australian markets. In 1989 the Griffiths Committee reported that:

> Recent figures indicate that the percentage of the population holding shares in Australia is well below that of countries such as the United States and the United Kingdom.... If Australia is to increase its current levels of investment, the importance of which cannot be over emphasised, then potential investors among the public must have confidence in the integrity of the securities markets.[112]

At an international level also, "investment confidence in Australia is haemorrhaging because of our reputation for rigged, corrupt markets where the competition is done by foul means rather than fair".[113]

8.2. Recent regulatory improvements - are they sufficient?

8.2.1. Introduction

The general perception is that the regulatory problems to date in respect of market manipulation have been with the enforcement of the legislation rather than the

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[110] Tomasic, Jackson, et al, "*Corporation Law - Principles, Policy and Process*" (Butterworths, Sydney,1990) p830.

[111] Australian direct participation rate - in 1986, 9.2% adult population held shares in listed companies, by Sept 1988 it had declined to 9%. - Contrast 12-16% equivalent rate in UK (1985), 20% equivalent rate in US (1985) and in Canada the participation rate increased from 13% to 18% (1983 to 1986) Hambrook, folio "Misconduct in Securities Dealings: Keeping the Ring" (1991) pp1,2.
1991 ASX Shareholder Survey of direct private ownership in Australia revealed that the level of direct ownership had risen to 10.2%. This increase may have been due in part to the introduction of dividend imputation and the Commonwealth Bank float.

[112] House of Representatives Standing Committee on Legal and Constitutional Affairs, *Fair Shares for All: an outline of the Issues and Alternatives* (AGPS Canberra, 1989) The Griffiths Committee at 5.3.9.

[113] Braithwaite, "Penalties for White-Collar Crime" in Grabosky (ed), *Complex Commercial Fraud* (Aust Institute Criminology, 1991) 167, 168.

provisions themselves. Submissions to the Lavarch Committee[114] commonly identified "the ability of the regulators to detect breaches"[115] as the source of the problem, being one of "effective enforcement rather than content of the law."[116]

Manipulative conduct is inherently difficult to detect, and the task of establishing the requisite intention in respect of the market behaviour is onerous. In addition, regulatory authorities have, in the past, lacked the resources necessary to pursue a crime of such elusive and indefinite character, weighing up the prohibitive costs of bringing an action against the perceived low chances of success. Recent developments in market surveillance technology and the increased investigatory powers and resources of the ASC, should significantly overcome these obstacles to the effective enforcement of our anti-manipulative provisions. The question remains, however, whether these improvements, although substantial, are sufficient in themselves, or whether further change is in fact necessary.

8.2.2. Improvements in Market Surveillance

Prior to the *Tuckwell*[117] prosecution, the only major case of market manipulation, *North v Marra*,[118] was brought by one of the parties concerned, and arose in respect of a claim by stockbroking company, Norths, to recover fees in respect of an illegal course of dealing. However, with Tuckwell, the detection capabilities of

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[114] House of Representatives Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders* (AGPS,Nov 1991) Report of the Lavarch Committee at 2.3.1.

[115] Submission of Westpac Banking Corporation - evidence S 275.

[116] Submission of the Australian Stock Exchange - evidence S 819.

[117] As above, fn 71.

[118] As above, fn 8.

the ASX Surveillance Division were revealed, producing its first prosecution since its inception in March 1989.

The impact of computerised trading on SEATS (Stock Exchange Automated Trading System), in terms of the increased surveillance and detection potential, has been dramatic.[119] For the first time, every movement of the market is documented to one hundredth of a second, providing a perfect record of all trading activity on the exchange. This information can then be analysed and even replayed in court, to provide a clear visual account to the jury of the trading activity forming the circumstantial case of the alleged manipulation. The role of the Surveillance Division in detecting and investigating unusual market movements is further assisted by the ASX's SOMA (Surveillance of Market Activity) software which reacts to unusual movements in market price and volume. Where the unusual movement cannot be adequately explained by information available to the exchange, and upon preliminary enquiry it appears there has been a breach of securities legislation, a report is sent to the ASC. The ASC will then determine whether to pursue the matter, and a recommendation may be made to Companies Division to suspend the securities until the situation is clarified.

As the parameters of the surveillance system are progressively fine-tuned, more subtle market anomalies will be caught by the system. At the same time, the number of unusual market movement alerts not requiring further investigation will be reduced,[120] rendering the detection system more precise and ultimately more effective.

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[119] 1. Berry and Yanco, "The Computer Police" *Charter* (Aug 1990) 22.
2. Berry and Yanco, "Enter the ASX Computer Police" *Jassa* (March 1990) 1.
3. Speech by Jim Berry, Manager, Surveillance, Australian Stock Exchange Limited, *Insider Trading Reforms Too Far or Not Far Enough* (*BLEC*, 1991) pp68-70.

[120] In the space of one year (1990/91) the number of alerts fell from 173 to 140 per day, and the figure is expected to improve further. As above.

As well as increasing dramatically the level of detection of unusual trading activity in the market for purposes of investigation, it is also anticipated that the widespread awareness of market surveillance activities will act as a deterrent.[121] It is hoped that, as would-be offenders realise that schemes of this nature will no longer escape undetected, the incidence of unacceptable market behaviour will be reduced, improving the reputation of the Australian securities industry.

8.2.3. The new improved ASC

The role of the new and improved ASC in generating this deterrent effect is significant. Awareness of the increased funding and powers of the ASC is widespread, its enforcement drive epitomised by the notorious ASC "hit list" targeting 16 major Australian companies.[122] Indeed, in the course of the *Tuckwell* case, Tuckwell argued strongly that with ASX Surveillance and the perceived pressure upon the ASC to produce results, no one could reasonably believe manipulative activity would go undetected: why would anyone risk such behaviour in the current climate of increased detection and investigatory capabilities with the ASC keen to redeem the previous neglect in corporate regulation by its predecessor the National Companies and Securities Commission (NCSC)? It is this deterrent influence by which the ASC hopes to discourage the great majority of would-be market manipulators before the event, thus improving the quality of the Australian securities industry in creating an environment of pro-active compliance.

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[121] The deterrent effect of increased surveillance capabilities exists at both a general and individual level. As an illustration of individual deterrence, Berry states that when queries are sent to brokers concerning particular trading activity, the activity generally ceases. Awareness of the increased scope of ASX surveillance also acts as a more general deterrent against conduct of this kind.

[122] Editorial, "Corporate Cops have just begun" *Aust Financial Review* 2 June 1992, 16.

Further, to the extent that manipulative conduct is not deterred, the ASC has the increased funding,[123] technological resources, investigatory powers[124] and centralised co-ordination to enable it to effectively target unacceptable market behaviour as never before. Previously, the regulatory efforts of the NCSC were severely hampered by inadequate resources and a lack of accountability.[125] In addition, federal fragmentation between the NCSC and State Corporate Affairs Commissions resulted in administrative inefficiencies and lack of overall direction.[126] By contrast, the ASC is potentially a powerful new force in corporate regulation with a stated commitment to effective enforcement of Australian securities laws.[127]

However, the ASC's record of enforcement to date compares rather poorly with the high expectations surrounding its introduction, and its failure to bring important matters to account has been criticised.[128] Ultimately though, the ASC is a relatively new and inexperienced body,[129] and as commented by former NCSC chairman,

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[123] The appropriation of the NCSC in 1989-1990 was $6.7m. The 1990-1991 Commonwealth Budget provided the ASC with an appropriation of $37.7m for its first year and $118.2m over the forward estimates period: Lavarch Report, at 2.5.3., 2.5.6.

[124] The ASC has extensive investigative powers conferred on it by s13 *ASC Act* to make "such investigation as it thinks expendient for the due administration of a national scheme law" where it has reason to suspect a breach. Lavarch Report, at 2.4.2.

[125] No single government under the co-operative scheme was responsible for the NCSC. Responsibility rested with the Ministerial Council which represented Australia's eight governments, and the Commonwealth, although providing half the funding, could not make changes without the support of the other governments. The Commonwealth government now has sole responsibility for the regulation of securities markets on a national basis. Latimer, "Securities Regulation Laws: What are they trying to achieve?" *Corp Management* (Oct 1992) 213 at 215.

[126] Lavarch Report, at 9.

[127] The ASC has emphasised that "enforcement of the law will be its (the ASC's) prime focus and commitment," with an enforcement brief to pursue and prosecute contraventions "to the limit." Lavarch Report, at 2.5.9, 2.7.12.

[128] For example, *The Advertiser* 7 Aug 1992, 24, *The Weekend Australian* 12-13 Sept 1992, 24, *Aust Financial Review* 2 June 1992, 16.

[129] The ASC took over companies and securities administration from the former NCSC and State and Territory Corporate Affairs Commissions on January 1, 1991. Latimer, "Securities Regulation Laws: What are they trying to achieve?" *Corp Management* (Oct 1992) 213 at 215.

Henry Bosch: "As the ASC gets into its stride, I think you will hear a great deal more from them."[130]

8.3. Beyond the improvements

Recent developments in market surveillance technology and regulatory structure will significantly advance the development of an effective system of prevention and control of market offences, including market manipulation, in the Australian securities industry. However, further change may be required to bring the quality of our markets up to international standards, convincing major trading partners that Australian regulatory authorities are indeed serious about the enforcement of securities laws, and inspiring confidence in the fairness of our trading markets.

Contrary to the general tenor of submissions to the Lavarch Committee[131] mentioned earlier, therefore, I do not believe that it can be merely assumed that the current legislative prohibitions against market manipulation are adequate, and that the regulatory problem in the past has been one of detection and enforcement alone. Rather, a full reassessment of the regulatory objectives and the means of achieving them is required, in order to fully capitalise on the potential benefits of the new developments, and equip the Australian securities industry to compete on a world scale in the increasingly international markets of the 21st century.

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[130] Bosch, Corporate Practices Seminar, "*Company Directors and the Law - What a Director must do*" (Adel 13 May 1992).

[131] As above, fn 114.

Our current legislative provisions have remained essentially unchanged since their introduction in 1980, and despite a glaring lack of prosecutions, have been subject to little substantive scrutiny. Ultimately, our law enforcement is only as good as the legislative provisions underlying it. Regardless of recent improvements in market surveillance and investigatory capabilities, as long as manipulative trading activity fails to be effectively targeted in this country, our securities markets will lack the international credibility so integral to their continued viability.

Recent years have seen a flurry of legislative reform activity in response to the corporate excesses of the 80s,[132] seeking to improve corporate and securities regulation in this country.[133] However, attention has focused on the offence of insider trading with the introduction of a comprehensive range of provisions last year, noting also the continuing legislative debate over directors' duties. The offence of market manipulation is equally in need of urgent reform, if the Australian securities industry is to gain the respect of the international business community and the confidence of its own public: "no market with a reputation for manipulation can flourish."[134]

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[132] The banking deregulation and ready availability of credit in the early 1980s produced an investment boom which was followed later that decade by a spate of corporate collapses. Many fraudulent practices were revealed, including various forms of market manipulation, falsification of accounts and misleading company reports and prospectuses, and confidence in Australia's market integrity "reached an all-time low". Weinberg, "Complex Fraud Trials - Reducing their Length and Cost" (1992) 1 *JJA* no 3, 151 at 152.

[133] "The Attorney General, Michael Duffy, anxious to give the community an indication that the Government is keen to eradicate certain corporate fraud and misdeeds which highlighted the 1980s, has introduced and foreshadowed a series of legislative initiatives which are breathtaking in their coverage of material and in their potential for change." Baxt, "Is There Too Much Law Reform" (1992) 20 *ABLR* 259.

[134] Gunningham, "Futures Market Regulation in Australia - Part II" (1992) 66 *ALJ* 128 at 132.

Chapter 9. REASSESSING THE CRIMINAL/CIVIL BALANCE

9.1. Introduction

An evaluation of the current legislative approach to market manipulation must include a consideration of the respective roles of the civil and criminal laws in its enforcement.

9.2. The criminal law - deterrent value

The advantages of the criminal law approach stem largely from the deterrent[135] value of its sanctions, in particular the threat of imprisonment, and the stigma attached to the criminal process: "the thing that most scares white collar criminals is the thought of incarceration".[136] The deterrence from crime is a desirable social goal, and the threat of punishment may be justified as a means to this end, a"device to deter from lawbreaking."[137]

However, it is questionable to what extent manipulative market behaviour is in fact deterred by criminal sanctions that are seldom, if ever, invoked. Human behaviour depends largely upon a weighing up of the relative costs and benefits to be derived

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[135] At a general level, the threat of sanctioning acts to deter misconduct. At an individual level also, sanctioning may render miscreants less likely to reoffend.

[136] "The White Collar Crime Mystery" editorial *Sydney Morning Herald* 9 March 1992, 10 - quoting Commonwealth Director of Public Prosecutions, Michael Rozenes QC.

[137] Elliston and Bowie, *Ethics Public Policy and Criminal Justice*, p195.

from a particular course of conduct. People "violate the law only if they feel that the benefits of law breaking warrant the risk of paying the cost".[138] Factors taken into account include an assessment of the severity of the penalty threatened and the likelihood of actually incurring it. Criminal sanctions alone may therefore prove of little deterrent value, particularly, as here, where the perceived risks of prosecution and conviction are low.

A broader scope of more flexible, civil sanctions, although less severe than criminal penalties, may in fact better serve the social goals of deterring such conduct. Increased reliance on civil sanctions provides an extended breadth of enforcement capabilities, whilst avoiding those incumbent difficulties which render sole reliance on a criminal approach largely inadequate in the commercial context. In this way, the criminal sanction remains as a warning "of the availability of the full treatment",[139] retaining its essential deterrent value, but is supplemented in practice by a range of alternative and better suited means of redress. The ASC argues that the deterrent effect of these alternative civil sanctions themselves should not be underestimated, often imposing substantial personal and immediate liability for compensation and damages.[140] The greater accessibility and range of enforcement options provided by such remedies may offer a far more real and immediate disincentive to would-be offenders than the more distant and elusive criminal sanction.

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[138] At p217.

[139] Ball and Friedman, "The Use of Criminal Sanctions in the Enforcement of Economic Legislation" (1965) 17 *Stan LR* 197 at 215.

[140] Hartnell, "Regulatory Enforcement by the ASC; an Interrelationship of Strategies" (1992) *ASC Digest* Rep Spch 38 at 48.

9.3. The role of the civil sanction

9.3.1 Background

The abovementioned benefits of the civil approach are reflected in the general shift evident in companies and securities legislation, away from sole reliance upon the criminal law towards placing a greater emphasis on civil, discretionary sanctions.[141] Up until and including the 1961 uniform companies legislation, the only general sanction provided was criminal. Then, in 1967, the Eggleston Committee[142] recommended the introduction of civil sanctions in the takeovers context as a supplement to traditional criminal sanctions in the enforcement of substantial shareholding disclosure requirements.

However, the real impetus for change in Australian sanctioning policy has emanated from the US experience, with its comprehensive enforcement scheme comprising a range of criminal, administrative and civil sanctions.

9.3.2. The US experience

The US approach incorporates a wide range of enforcement alternatives, including a substantial breadth of civil options, to achieve maximum efficiency and deterrence from the SEC's enforcement programme. Unlike the ASC, the SEC

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[141] Duns, "A Silent Revolution: The Changing Nature of Sanctions in Companies and Securities Legislation" (1991) 9 *C & SLJ* 365 at 367, 369.

[142] Company Law Advisory Committee to the Standing Committee of Attorneys-General, Second Interim Report: *Disclosure of Substantial Shareholdings and Takeovers* (1969) The Eggleston Committee p6.

disclaims its role as a collection agency to obtain damages for private investors. However, it may bring injunctions requiring disgorgement of illegally obtained profits.[143] As well as reference to the Attorney General for criminal prosecution, various civil orders are available to the SEC. These include the power to suspend trading pending legal action,[144] and suspension or expulsion from the exchange where such action is deemed necessary for the protection of investors.[145]

In particular, the injunction[146] has been used extensively to enforce US securities laws. The SEC is mindful of its role as statutory guardian, charged with safeguarding the public interest,[147] and is keen therefore to quickly "nip manipulations in the bud."[148] To this end, the consent injunction has been developed as a useful enforcement tool, enhancing regulatory efficiency and bringing about effective and speedy compliance.

Where a breach is alleged, the SEC can bring a civil action for an injunction enjoining further violations, to which the defendant may consent without admitting or denying the allegations of the complaint. Additional orders can then be attached to the injunction as appropriate, including orders to disgorge profits,[149] freeze

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143 Friedman, *Securities and Commodities Enforcement* (Lexington Books, Lexington, Mass, 1981) p53.

144 As in the case of *SEC v Metzinger*, civ 89 -Z-227 (D Colo 23 Feb 1989) Lit Rel No 12020.

145 Under s19(a)(3) *Securities & Exchange Act* 1934 (US). In the case of *Charles C Wright* 12 SEC 100 (1942), aff'd 134 F 2d 733 (2d Cir 1943) a dealer's actions contravening s9(a) involved such a wilful breach of fiduciary duty to investors for whom he was acting as agent, as to require his expulsion from the exchange. Similarly, in the case of *Kidder Peabody* No 2290 SEC File No 8-1 (April 2, 1945) suspension from the exchange was deemed necessary in the public interest, although the further sanction of revocation of registration was held to be unnecessary.

146 As provided for by s21(d) *Securities and Exchange Act* 1934 (US).

147 Friedman, *Securities and Commodities Enforcement* p36.

148 Loss, *Securities Regulation* p1569.

149 As in *SEC v Porto* civ 88-C-0239 (N D I 11 Jan 12, 1988) Lit Rel No 11659.

assets,[150] and disqualification from affiliation with investment[151] or brokerage firms.[152] In this way, the manipulative conduct is quickly and effectively eliminated, with flexible conditions imposed as necessary to deal with the situation at hand.

The benefits of such an approach are readily discernable in the greatly expanded potential for controlling the incidence of manipulative trading activity in the market. The SEC can target a broad range of possible breaches of securities legislation, and avoid difficulties of proof. Wrongful conduct is stopped without any loss of face to the perpetrator whose guilt is never established. The punitive element is clearly lacking, however, and is replaced by a somewhat negotiatory emphasis. The consent injunction should thus form only a part of the enforcement weaponry.[153]

9.3.3. Civil sanctions in Australia

In Australia, the legislative approach of today follows the lead of the US. Both criminal and civil sanctions are incorporated, to more fully equip regulatory authorities with the necessary enforcement mechanisms to restrain and redress corporate wrongdoing. These civil actions may be sought by aggrieved parties

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150 As above.

151 As in *ZICO*'s Case, fn 16.

152 *Siegel* Exch Act Rel 34-24719 (21 July 1987).

153 A similar approach was adopted in Australia in the context of an investigation of share purchases in Little River Goldfields NL in 1990 for suspected breaches of s128 *Securities Industry Code* (NSW). The ASC subsequently announced it had reached an agreement with the parties involved, who agreed to pay moneys to the ASC *without admission of liability* (ASC Media Release 91/182, 12 Dec 1991).

where there has been a contravention of the Corporations Law, either in their own right, or by the ASC on their behalf :s50. Section 1330 also allows the ASC to intervene to assist in existing proceedings and is of particular relevance where matters of national significance are involved, or the construction of the Corporations Law is in issue. Civil enforcement of the Corporations Law is thus implemented by a combination of both private actions and ASC initiated suits to achieve maximum accessibility and enforcement spread.

Where a breach of the market manipulation provisions of ss997, 998 is alleged, the accused, as well as being subject to criminal prosecution,[154] may be civilly liable to compensate any buyer or seller of the relevant securities who suffers loss or damage by reason of the contravention, whether or not a conviction results: s1005(1). This statutory claim for compensation arises under ss1005, and the relevant burden of proof is on the balance of probabilities: s1332. In addition, s1324 enables anyone whose interests have been, are, or would be affected by a contravention to seek an injunction or damages. Restraining orders against dealing in securities, and orders declaring a relevant contract to be void or voidable are also available: s1114.

The case of *NCSC v Monarch Petroleum NL*[155] involved the making of such an order. The case concerned stock exchange trading contracts in the context of an announcement based on a forged letter. The letter contained references to a possible takeover and a significant oil discovery, and its source was unknown.

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[154] Criminal penalties for misconduct in securities dealings are a fine of up to $20,000 or imprisonment up to 5 years or both: ss1311 (2),(3).

[155] (1984) 8 ACLR 785.

Nicholson J in granting the order to void the contracts, stated that it was "very much in the public interest that persons engaged in a fraud of this type should be prevented from profiting by it."[156] Although the perpetrators in this case were unknown, and could not be prosecuted, "any law which operates to render their efforts fruitless might be thought to constitute a very real deterrent to such person's activities."[157]

The *Golden Bounty* matter provides a further illustration of the range of civil orders available to the ASC where manipulative conduct is alleged. Investigation into share trading in Perth mining company Golden Bounty Resources NL was commenced in response to trading of 6.5m shares at prices which rose from 6c to 35c during trading on August 24, 1990. The stock had previously traded lightly causing suspicion to be aroused. The NCSC initially suspended trading in the stock from August 24 to November 12, 1990 in order to carry out investigation of the matter. In addition, interim injunctions[158] were obtained on November 12, restraining the parties to the conduct from acquiring or disposing of Golden Bounty shares pending civil action by the ASC. Then, on September 30, 1991, the Supreme Court of Victoria made final orders in respect of the conduct. It was held that manipulation had occurred in breach of s123 *Securities Industry* (Vic) *Code* in the effecting of transactions raising the price of Golden Bounty securities on the Australian Stock Exchange with intent to induce other persons to purchase or subscribe for the securities. The court ordered that 4m shares still held by the parties be vested with the Commission for orderly disposal and declared certain contracts associated with the conduct void.[159]

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156 At p794.

157 As above.

158 under s149 *Securities Industry* (Vic) *Code*.

159 ASC Media Release 171, Sept 30, 1991.

Manipulative conduct was also alleged in the *Precision Data* matter in the context of a takeover bid by Titan Hills Australia Ltd in May 1991. On May 6, 1991 the ASC applied for an injunction to postpone a meeting of Titan Hills shareholders regarding the acquisition of Precision Data Holdings Ltd, on the basis of alleged market rigging and a flawed independent report into the takeover bid. The allegations concerned bids placed at intervals between 1c and 20c, gaining a trade at 20c just before the close of trading.[160] However, Precision rejected the market rigging suggestion and the ASC's application was dismissed. Jenkinson J in the Federal Court stated that he had heard insufficient direct evidence to support the ASC's suspicions:

> All that can be inferred about the suspicion is that it is of misleading conduct on the part of the directors of Titan Hills Australia Ltd in connection with ... a proposed takeover by that company of Precision Data Holdings Ltd, and of transactions in securities of a body corporate, to which Dabby Pty Ltd may have been a party, having or likely to have the effect of reducing the price of securities of that body corporate on a stockmarket.[161]

The ASC then resolved to apply to the Corporations and Securities Panel[162] for a declaration under s733 CL that certain acquisitions of shares in Titan Hills and Precision Data were unacceptable in the context of the takeover.[163] The panel

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160 Pheasant, "ASC's Court Bid to halt Titan meeting fails" *Aust Financial Review*, 7 May 1991, 16.

161 *Australian Securities Commission v Graco* (1991) 29 FCR 491 at 499.

162 Section 171 of the *ASC Act* (1989) provides for a Corporations and Securities Panel "which can declare a proposed takeover or conduct by persons in relation to a company's affairs to be unacceptable in the public interest, where there has not been an informed market in relation to the takeover or the conduct. Matters are referred to the panel by the ASC." Lavarch report, at 1.3.28.

163 ASC Media Release 4 July 1991.
The Panel is empowered by s734 to make a wide range of orders following a declaration under s733. These include orders relating to the cancellation of an agreement in relation to the disposal or acquisition of the shares and any other orders that it thinks necessary to protect the interests of a person affected by the acquisition. *Australian Corporations Law Guide* (CCH Australia, North Ryde NSW, 1991) p271.
In this case, the ASC sought an order that the "Takeover Scheme be cancelled and that such shares as Titan Hills has issued as consideration under the Takeover Offers be cancelled." ASC Application to Panel, 4 July 1991.

hearing was delayed by a High Court challenge to its constitutional validity.[164] Further, the ASC's attempt to seek interim orders from the Panel to maintain a status quo pending its final declaration[165] was thwarted by a Full Federal Court finding that the Panel lacked such a power,[166] and must instead seek a court injunction to that effect. When the Panel finally reached its decision on December 20, 1991,[167] it found that arrangements had been made between the parties ameliorating the effects of the conduct, and that no declaration of unacceptable conduct or acquisition would be made as a result.

9.4. The ASC's civil emphasis

9.4.1. ASC - regulatory philosophy

The most attractive features of the civil action are undoubtedly its speed, flexibility, and lower standard of proof, rendering it highly suited to the complexities of corporate crime. The ASC has turned increasingly to civil actions, enabling it to quickly and effectively act to remedy the problem at hand, in preference to the slow and frustrating process of criminal prosecution. As Queensland regional commissioner Barrie Adams has stated, "I believe it is much better to get in there [and] stop the offence occurring."[168]

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164 The High Court held on October 24, 1991 that the panel was constitutionally valid. *Precision Data Holdings Ltd & Ors v Wills & Ors*(1991)6 ACSR269.

165 ASC Media Release 4 Sept 1991.

166 *Cullen v Wills* (1991) 31 FCR 19.
The Attorney General, Mr Duffy, has since amended the panel's powers; inserting s733A CL to the effect that the panel can now make interim consequential orders pending its determination of an application for a declaration of unacceptable conduct or acquisition. Potter, "Panel's powers restored" *The Age*, 12.Dec 1991.

167 *Corporations and Securities Panel Decision and Statement of Reasons*, 20 Dec 1991.

168 Cromie, "Holes in the Corporate Net" *BRW* 19 June 1992, 64 at 66.

The aim of the ASC is law enforcement.[169] However, there was a growing perception throughout the 1980s that the Australian securities laws were not being enforced. As a result, the ASC has felt it necessary to adopt more accessible avenues of enforcement in order to build essential public confidence in investment in the Australian corporate sector. To this end, the ASC has developed a three-pronged approach to corporate regulation - prevention, recovery and prosecution - encouraging a greater and more immediate enforcement spread and promoting above all an "environment of compliance".[170] The emphasis is now on the development of a pro-active enforcement structure, with the implementation of a formidable deterrent net comprising enhanced surveillance capabilities and comprehensive sanctioning capacity.

The focus of the regulatory system described above lies with its recovery and prevention components. It relies primarily on the use of injunctions and civil recovery actions to restrain misconduct and recover misappropriated funds,[171] backed up by the criminal prosecution as an additional deterrent. Although the ASC recognises the continued importance of the criminal prosecution in corporate and securities crime - "I regard prosecution for criminal breaches of corporate law to be an important part of the ASC's overall enforcement strategy" (Hartnell)[172] - it is quick to point out that prosecuting the thief does not benefit those whose money was stolen.[173] Rather, the ASC believes that civil action is better suited to provide effective remedies for the benefit of those investors most directly affected by the misconduct and should thus be pursued as a first priority. Thereafter, "the wider

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169 Hartnell, "Corporate Regulation in Australia: The aftermath of the 1980s" (1991) *ASC Digest* Rep Spch 3 at 5.

170 Menzies, "The Investigative Powers of the ASC" (1991) *ASC Digest* Rep Spch 106 at 121.

171 Williams, Address to Business Law Education Forum (1991) *ASC Digest* Rep Spch 37 at 43.

172 Hartnell, "The National Companies Scheme: The ASC's approach to enforcement" (1990) *BCLB* no 6, 82 at 87.

173 Cranswick, "Background to the Corporations Law and the ASC - the ASC's philosophy" (1991) *ASC Digest* Rep Spch 80 at 81.

public interest should be satisfied" in the bringing of criminal proceedings as appropriate.[174]

As a result, the ASC considers the public "thirst for blood"[175] and focus on "head counting" by way of statistical summaries of arrest, prosecution and conviction[176] to be highly inappropriate in this context. It is argued that an enforcement philosophy of compliance cannot be measured in terms of prosecutions alone, as its ultimate objective is an "absence of misconduct",[177] which by definition, cannot be quantified.

9.4.2. ASC/DPP tension

It is upon this very issue of regulatory philosophy that tension has arisen between the ASC and the Commonwealth Director of Public Prosecutions (DPP), since the DPP was given the role of prosecuting corporate crime in January of last year. Under s99 of the *ASC Act* and s1315 of the Corporations Law, the ASC is empowered to initiate and conduct criminal proceedings. However, in all but minor offences, prosecutions are generally to be undertaken by the DPP, pending referral by the ASC. Thus, although the DPP is ultimately responsible for the prosecution of corporate misconduct in breach of the legislation, it can only become involved at the behest of the ASC.

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174 Menzies, "The Investigative Powers of the ASC" (1991) *ASC Digest* Rep Spch 106 at 111.

175 "The White Collar Crime Mystery", *Sydney Morning Herald*, 9 March 1992 p10.

176 Hartnell, "Regulatory Enforcement by the ASC; an Interrelationship of Strategies" (1992) *ASC Digest* Rep Spch 38 at 53.

177 At p54.

In this context, the stated preference of the ASC to pursue civil proceedings at the expense of the criminal action has divided the two organisations, when in fact their full co-operation is of critical importance in raising the profile of corporate regulation in this country. Commonwealth Director of Public Prosecutions, Michael Rozenes, has stated: "The DPP is not confident that all matters appropriate for prosecution under the Corporations Law are being referred to it by the ASC."[178] It would appear that the DPP feels its role is being wrongfully undermined by the ASC's civil emphasis, opting for civil sanctions in situations where criminal action may be appropriate.

A case in point is the recent *Adelaide Steamship* matter. The ASC originally initiated in November 1991, civil proceedings in the Federal Court on behalf of David Jones Ltd against chief executive officer John Spalvins and director Michael Kent. The claim related to group share trading activities entered into by the respondents between November 1985 and April 1986 on behalf of Adsteam and David Jones. These transactions were allegedly in breach of the requisite duties of care, honesty and diligence[179] owed by the respondents in their capacity as directors of David Jones. It was alleged that in failing to disclose the group share trading scheme entered into by them on David Jones' behalf, and depriving David Jones of any share of the profit of that scheme, they had acted contrary to the interests of David Jones, breaching their abovementioned duties of office. However, the legal proceedings described above were subsequently dropped by the ASC, which was unable to define any personal benefit from the trading activities

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178 Spiers, "DPP accuses ASC of going soft on crime" *Aust Financial Review* 8 Sept 1992, 1.

179 As required by s229(1) *Code*, now s232 CL.

on the part of the respondents.[180] Instead, the matter was settled by Adsteam paying its associate company David Jones $3 million and the respondents paying $50,000 towards the ASC's legal costs, precluding the taking of any further legal action.

The whole matter has become a rather "sensitive issue" for the ASC.[181] It has been suggested that the settlement is highly reminiscent of the NCSC's predilection for the use of commercial pressure to bring companies into line instead of resorting to the courts. However, whilst the NCSC's policy of regulation by commercial settlement was largely forced upon it by a lack of adequate funding, the ASC has "ample resources and powers" to pursue corporate criminals "to the hilt".[182] Consequently, the ASC has been criticised for its perceived failure to take a 'hard line' on corporate misconduct, opting for a more conciliatory approach to corporate regulation. Indeed, the ASC failed in this case even to prepare a brief for the DPP, and so excluded altogether the possibility of criminal charges being laid in respect of the conduct.

Hartnell has been adamant in his justification of the ASC's willingness to settle, claiming that the ASC "had never alleged that Spalvins and Kent were dishonest, rather that profits from share deals had not been properly accounted for".[183] Such an assertion sits uncomfortably with allegations made by the ASC in its Statement of Claim that the respondents "did not act honestly in the exercise of [their] powers

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[180] ASC Media Release 92/58.
"At present, the ASC has not seen any evidence to suggest that Messrs Spalvins and Kent obtained any personal benefit from these trading activities." ASC Media Release 79, 3 April 1992.

[181] Cromie, "Holes in the Corporate Net" *BRW* 19 June 1992, 64 at 66.

[182] "The White Collar Crime Mystery", *Sydney Morning Herald*, 9 March 1992, 10.

[183] As above, fn 181.

and the discharge of the duties of [their] office".[184] Further, it was alleged that the respondents conspired in conduct which was misleading and deceptive,[185] failing to disclose to David Jones the nature, or even the existence, of the secret deal.[186]

It must be presumed that Spalvins and Kent were in fact innocent of the allegations made in the Statement of Claim. I merely point out the apparent disparity between the serious nature of these allegations, and Hartnell's subsequent justification for the ASC's opting to settle. If it was never alleged that the respondents were "dishonest"; it was certainly alleged that they had failed to act "honestly". Yet at no stage was a brief given to the DPP with a view to considering whether there was sufficient evidence on which to bring criminal charges, despite the undeniable breaches of the Corporations Law alleged in the Statement of Claim.

It is this type of enforcement approach by the ASC that is leading to concern on the part of the DPP that the ASC will increasingly opt to pursue civil remedies at the expense of criminal investigation, provoking fears of a "de facto abandonment of resort to criminal prosecutions".[187] Commonwealth Director of Public Prosecutions, Michael Rozenes states that "civil action cannot, in the case of fraud or dishonesty, be an adequate or effective deterrent."[188] However, the frustration of the ASC with the delays of the criminal process is clear: "We are trying to achieve what is plainly impossible, namely a speedy result for the Australian criminal law process."[189]

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184 Statement of Claim para 27.1.

185 Contrary to s52 *TPA*, Statement of Claim para 27.1.2.

186 Statement of Claim para 26.

187 Tomasic, "Sanctioning Corporate Crime and Misconduct" (1992) 2 *Aust Jnl Corp Law* 82 at 93

188 Rozenes, in Cromie "Holes in the Corporate Net" *BRW* 19 June 1992, 64 at 66.

189 As above, per Hartnell.

The simmering tension between the two bodies finally erupted into a bitter public struggle in early September of this year, in the wake of the ASC's reported decision to withdraw resources from its investigation into Budget Corporation.[190] Hartnell had previously referred to the matter as one of the ASC's "significant investigations".[191] Rozenes criticised the ASC's failure to continue with the investigation, claiming the ASC has "gone soft on chasing corporate criminals."[192] Hartnell retaliated by citing a lack of confidence in the speedy conclusion of the matter as motivating the withdrawal, accusing the DPP of taking "too long to act on the results of ASC investigations."[193]

In the meantime, the image of corporate regulation in Australia, including the regulation of market manipulation, continues to suffer as a result of the obvious lack of a clear enforcement direction which plagues our enforcement agencies. If our enforcement agencies cannot agree amongst themselves as to regulatory policy, how can they ever hope to inspire the confidence of the rest of the investing world in our markets.[194]

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[190] Pheasant, "Hartnell dropped 'old tale' to save money" *Aust Financial Review* 8 Sept 1992, 4.

[191] Furness, "Corporate crime clash a matter of style" *The Australian* 9 Sept 1992, at 37.

[192] Sealey, "Duffy tries to end ASC row" *The Advertiser* (Adel) 9 Sept 1992, 40.
"There must not be special rules for corporate criminals simply because they wear white shirts and carry briefcases ... the threat of prosecution action must remain an important strategic weapon to be used by the corporate regulator." *Corporate Prosecution in Australia*, Submission by the Director of Public Prosecutions to the Joint Parliamentary Committee, (7 Sept 1992) at 3, 6.

[193] Sealey, as above, fn 192.

[194] In an attempt to resolve the public disagreement which has arisen between the ASC and the DPP, a memorandum of understanding (MOU) was signed by the two bodies on 22 Sept 1992. The purpose of the MOU is to overcome the differences between the ASC and DPP in respect of the investigation and prosecution of corporate crime. It seeks to involve the DPP at an earlier stage in ASC criminal investigation and ensure that the focus of the investigation is agreed (para 4.5): "The relationship between the DPP and the ASC during the process is expected to be co-operative, recognising the interests of both agencies in the securing of convictions in matters of serious corporate crime." (para 4.7).
In addition to the MOU, the Attorney General Mr Duffy has imposed a set of guidelines to ensure "collaboration, co-operation and joint review of investigations ... 'The guidelines in the direction will also ensure that a proper balance is maintained between criminal and civil enforcement'." Mr Duffy in Sealey, "Duffy orders ASC to lift its game" *The Advertiser* 7 Oct 1992, 40.

9.4.3. Perceptions of Australian regulatory timidity

Moreover, the ASC's civil enforcement philosophy, promoting an environment of compliance in the corporate sector, should not be pursued at the expense of a strong underlying policy of criminal enforcement. Just as sole reliance on a criminal approach is largely inadequate in the commercial context, lacking the flexibility and enforcement spread of the civil sanction, so should sole reliance on civil sanctions be similarly avoided. The 'compliance' emphasis of the ASC, if allowed to dominate corporate regulation in this country will only serve to enforce perceptions of Australian regulatory timidity.[195]

Braithwaite has noted with some concern that jokes about Australian business and regulatory institutions have become quite commonplace with a growing reputation for being 'soft' on corporate crime.[196] Such an attitude can no longer be tolerated. As the boundaries of international capital markets continue to expand, with the advent of a global borderless market,[197] the need for the regulation of corporate misconduct in Australia to be comparable with that of its major trading partners will become increasingly apparent. A strong and decisive enforcement approach is absolutely essential if Australian markets are to compete effectively at an international level. Only then will the rest of the world be convinced that Australia is taking "extraordinary measures to clean up its act";[198] building up essential confidence in stockmarket investment in this country. This confidence is sadly lacking at present.

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[195] Grabosky and Braithwaite similarly identify Australian business regulatory reluctance, seeking compliance through co-operation, not coercion: *Of Manners Gentle* p191.

[196] Braithwaite, "Penalties for White Collar Crime" in Grabosky (ed) *Complex Commercial Fraud* at 167.

[197] Lynch and Morse, "Insider Trading and Market Manipulation in the International Arena" Annual Conference of International Organisation of Securities Commissions (Melb Nov 1988) 2,33.

[198] Braithwaite, "Penalties for White Collar Crime" in Grabosky (ed) *Complex Commercial Fraud* at 170.

Chapter 10. PUTTING 'TEETH' INTO THE CRIMINAL LAW

10.1. Introduction

"Our society has hardly begun to comprehend the nature and extent of corporate crime, let alone reached the point of realising that our attempts to combat it are at a very primitive level."[199]

Braithwaite suggests that the only way to improve the credibility of Australian corporate regulation is to "put some teeth into corporate criminal law".[200] As far as the offence of market manipulation is concerned Australia has yet to achieve a successful prosecution;[201] and "a regulatory strategy without a credible threat of prosecution is no strategy at all."[202] Some re-examination of our current legislative provisions may thus be required, providing more fully for the effective regulation of conduct of this kind.

Substantive difficulties inherent in the offence of market manipulation as it currently stands have been identified in Part II of this thesis. The complexity of the provisions, and uncertainty as to what constitutes prohibited conduct, create unnecessary regulatory confusion. In addition, the need to prove the requisite manipulative intention beyond reasonable doubt has been identified as a source of

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199 Stipendiary Magistrate Goldrick, (1977) in Santow,"Regulating Corporate Misfeasance and Maintaining Honest Markets" (1977) 51 *ALJ* 541 at 543.

200 Braithwaite, "Penalties for White Collar Crime" in Grabosky (ed) *Complex Commercial Fraud* at 168.

201 Excepting the plea of guilty in *Moage*.

202 Weinberg, "Complete Fraud Trials - Reducing their Length and Cost" (1992) 1 *JJA* no 3, 151 at 153.

regulatory difficulty, particularly in the context of complex market crime. An attempt to overcome these regulatory obstacles follows.

10.2. The current offence: 'all or nothing'

The regulatory objectives underlying ss997, 998 are the creation of a genuine market, to provide "maximum efficiency" and to "protect the investor".[203] However, in focusing on the existence of the requisite intention to manipulate the market, it is submitted, the current provisions do not adequately protect the market against deceptive practices as a whole. The case of *Tuckwell*[204] provides a clear illustration.

Tuckwell was ultimately acquitted, having successfully rebutted the charge of trading with intention to create a false or misleading appearance of the price of Intrepid shares. Regardless of his intention, however, the placing of bids near the close and cancelling them before the opening of trading the next day, at various stages throughout the relevant period, was in itself misleading. An appearance of a genuine market for Intrepid shares was created, upon which the investing public was entitled to rely, but which was ultimately illusory, no 'real' bid having been made. The inability of the current offence to cater for trading activity which has the effect of misleading the market, but which lacks the requisite manipulative intention is thus revealed.

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[203] Aust, Parl, *Debates*, (1980) p1815.

[204] As above, fn 71.

Consider also the situation of the hypothetical trader who, acting through different brokers on the same day, sells a large parcel of shares to himself or herself in a wash sale arrangement. By virtue of s998(5), the trader is prima facie guilty of an offence under s998(1), unless it can be shown that the creation of a false or misleading appearance of active trading was not one of the purposes of the transactions: s998(6). Suppose our trader was having difficulty obtaining finance by conventional means, and had therefore arranged for the settlement of the share transaction to be on a deferred basis, enabling them in the meantime to draw on the credit created by the sale in the selling broker's account. Presumably it could be argued that the purpose of the trading activity was not to create a false or misleading appearance of active trading, but merely as a means of obtaining the short term financing that was not otherwise available. In this way, any finding of manipulative intention would be negated, defeating a charge of market manipulation in respect of the conduct. However, regardless of the motive for trading, the investing public would have been deceived into thinking that the X million shares traded had actually changed hands on that day. An appearance of actual trading would be created, which is ultimately false.

Both Tuckwell and our hypothetical trader, although lacking manipulative intent, are nevertheless abusing the integrity of the market. One placed illusory bids in order to 'test' the market, and the other used the exchange as a short term financing tool. Neither constitutes legitimate trading activity in the ordinary sense. It is, I believe, a fundamental weakness in the law that allows the market to be misled in this way, failing to target conduct which, although motivated by some non-manipulative purpose, has the ultimate effect of sending false signals to the market. Either way, the end result is just as dangerous, distorting the true market forces of

legitimate supply and demand, and undermining public confidence in the integrity and fairness of the market.

However, under the provisions as they currently stand, intention to manipulate the market must be proved, in order that the conduct be prohibited as manipulative. Conduct is either manipulative, possessing the requisite manipulative intent beyond reasonable doubt, or it is not. No middleground is allowed for. This, I believe, is a fundamental misconception underlying the current legislative approach, restricting unduly the ability of the statutory provisions to effectively target manipulative trading activity in the Australian securities industry.

Contrast, for example, the distinction between murder and manslaughter, where the more reprehensible offence of killing with intent is severely punished. However, the causing of a death without the intention to do so is punishable to a lesser degree nevertheless, by virtue of the act itself. Could the offence of market manipulation be treated in a similar manner? I would argue that the current 'all or nothing' approach is failing to sufficiently meet the regulatory objectives, which must surely be to create a genuine market for the trading of securities in which investors can have confidence.

10.3. Creating a middleground offence

Creating a middleground offence, focusing on the conduct itself, will have the effect of increasing the regulatory scope beyond the 'all or nothing' legislative approach currently restricting enforcement efforts.

10.3.1. An objective prohibition

In my opinion, the full offence, requiring proof of manipulative intention, should be retained for cases of truly criminal mens rea market manipulation in the conventional sense. However, falling short of this, an intermediate position should be established. A blanket prohibition should be imposed on specific types of market activity deemed in themselves to have a misleading effect on the market, carrying with it a lesser penalty of some kind. This more rigorous and comprehensive legislative approach will offer a greater degree of market protection. The varying degrees of criminality will be catered for, outlawing the acts themselves as well as providing for the possibility of full criminal sanctioning where the requisite intention can be established.

"Criminal laws that are almost never seen to be enforced are a shaky foundation on which to build a shame-based control strategy."[205] Expanding the regulatory potential of the current provisions will increase their profile and the frequency with which they are seen to be enforced, enhancing the deterrent value of the offence, which to date has been seen as "largely symbolic in nature".[206] It may even be hoped that in facilitating the use of the criminal law in this context, the working relationship of the ASC and DPP will be improved,[207] removing to an extent the difficulties which have made reliance on the criminal law prohibitive in the past.

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[205] Tomasic, "Sanctioning Corporate Crime and Misconduct" (1992) 2 *Aust Jnl Corp Law* 82 at 95.

[206] Tomasic and Pentony, "The Prosecution of Insider Trading: Obstacles to Enforcement" (1989) 22 *A&NZ Jnl Crim* 65 (in reference to insider trading but applies equally to.the offence of market manipulation).

[207] Bosch states that the current perception of the criminal law in this context is that it is "slow, expensive and most people get off." He states that until the laws are changed"you will have the sort of controversy that is occurring with Mr Hartnell and Mr Rozenes." Furness, "Corporate crime clash a matter of style" *The Australian* 9 Sept 1992, 37.

Proponents of the 'fuzzy law' approach[208] would argue that detailed drafting of the kind suggested, only encourages the devising of elaborate schemes to evade the provisions, creating a "roadmap for the unscrupulous".[209] This black letter/fuzzy law debate has gained prominence in the context of recent moves to reform the law of directors' duties, but its arguments are equally cogent in respect of corporate and securities regulation as a whole. It is argued that a general approach is far preferable in such an inherently complex field, allowing interpretation according to the spirit rather than the letter of the law,[210] and so ensuring maximum coverage. Indeed, it would be argued, market manipulation is such an intangible concept, that any attempt to definitively list those types of trading activity which have the effect of creating a false market would be inherently defective, its possibilities being endless. Surely however, the limitations of a finite list could be overcome by the addition of a catch-all phrase to the effect that all conduct having a similar effect on the market as those specifically listed would be similarly prohibited.

The resulting clarification of the elements of the offence will facilitate enforcement, setting out a list of prohibited conduct as creating a false market per se. In addition, traders themselves will be given a better idea of what they can or cannot do, as the bounds of acceptable and lawful market behaviour are more clearly delineated. Indeed, similar motivations in the takeover context[211] have resulted in the setting of an arbitrary 20% limit for substantial shareholdings across

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[208] Green, "Fuzzy Law, 80s Problems - 90s Solutions" at 1992 National Corporate Law Teachers' Workshop (Canberra Feb 1992).

[209] Corporate Practices Seminar, (Adel, 13 May 1992).

[210] Baxt, "Opening Address to 1992 National Corporate Law Teachers' Workshop" (1992) 2 *Aust Jnl Corp Law* 6 at 8-10.

[211] s615 Corporations Law.

the board. Such an approach avoids the need to weigh up the individual circumstances of each case, attaining the clarity and consistency that only a fixed objective prohibition can provide.

The need for clarification in the law as regards the offence of market manipulation has similarly been voiced in recent submissions to the ASC's public hearings on the practices of underwriters.[212] One submisssion by Sydney lawyer Michael Haines urges the ASC to consider substantial reform of sections 997, 998, in order to resolve current uncertainty in their operation, stating that "the meaning and coverage of sections 997 and 998 should be clarified". Further, he says that this clarification can be achieved "without unduly restricting the section's effectiveness against undesirable trading practices". Indeed, I believe the section's effectiveness would be significantly increased as a result.[213]

10.3.2. Section 995

Similarities are evident between the suggested middleground offence, and the provisions of s995 CL. Section 995 parallels s52 *Trade Practices Act* 1974 (Cth)

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[212] Lawson, "Market Rigging Law Forbids Price Stabilisation" *Aust Financial Review* 18 Aug 1992, 23.

[213] A further submission prepared jointly by Sydney Law Firm Rosenblum and Partners, and investment bankers Schroders Australia Ltd, advocates the legalisation of market stabilisation along UK, and US lines. Market stabilisation is currently prohibited by s997(7) in contrast to the US where s9(a)(6) only prohibits pegging, fixing or stabilising of securities prices when it is in contravention of the rules and regulations prescribed by the SEC. The submission seeks to allow underwriters to stabilise the price of securities they have underwritten "during the settling in period immediately after a flotation": p 8. Market stabilisation interferes with the free interaction of true market forces, artificially inhibiting price fluctuation and variation in the market, and as such, is at odds with the maintenance of a genuine market. However, it is claimed that such activities are already taking place, (p 8) but are not detected. It may thus prove more effective to permit the practice in controlled circumstances, ensuring adequate disclosure to the market: p 9.

and is intended as a catch-all provision, operating in addition to the specific prohibitions of ss997,998. Civil liability is imposed for the engaging in of conduct which is misleading or deceptive, or likely to mislead or deceive in any dealing in securities. Contravention of s995 gives rise to a wide range of orders under s1325, including compensation for persons who suffer loss as a result.

Section 995 was enacted in 1988 in order to protect investors more fully against "unscrupulous activity"[214] in the securities market. Its stated aim is to ensure that those who engage in misleading or deceptive conduct in the market run, at the very least, the risk of civil liability.[215]

It can thus be seen that the types of objective conduct sought to be specifically targeted by a middleground offence of the kind suggested, would also fall within the operation of s995. Indeed, the regulatory objectives are the same in each case: to expand the regulatory scope beyond that of the full criminal provisions of ss997,998. However, in spite of the apparent similarities, s995 is a civil provision only. It is submitted that, in the context of market manipulation, the criminal law itself must be expanded if it is to prove "an effective vehicle for the social control ... or for the deterrence of such conduct".[216]

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[214] Explanatory Memorandum to *Corporations Bill* (1988) p723.

[215] As above.

[216] Tomasic and Pentony, "The Prosecution of Insider Trading; Obstacles to Enforcement" (1989) 22 *A&NZ Jnl Crim* 65.

10.3.3. Sanctioning

Having thus identified the need for an objective prohibition of certain classes of market activity recognised as having a misleading effect on the market, supplementing the existing broadly stated criminal offence of market manipulation, it remains to determine the appropriate form of sanctioning to be adopted. The regulatory options for the intermediate offence are either to qualify the requisite mens rea or to exclude it altogether, in recognition of the lesser nature of the offence.[217]

One possibility would be to impose an absolute liability approach in respect of the new middleground offence, removing altogether the need to establish an intention to manipulate the market. Such an approach could be justified on grounds of public policy, requiring that the market be protected from all conduct that is misleading, irrespective of the state of mind of the perpetrator. It would be sufficient merely to prove the elements of the actus reus to incur the penalty, as in the imposition of traffic fines. If the integrity of the market is indeed paramount, the state of mind of the defendant, be it intention or knowledge, is irrelevant. It is enough purely for the market to have been misled as a result of their conduct.

The sanctioning method adopted by s232 CL in respect of directors duties provides an example of such an approach. Section 232(3) provides that where a director fails to act honestly in the discharge of the duties of their office with intent to

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[217] Williams, *Textbook of Criminal Law* (Stevens & Sons, London, 2nd edn 1983) p929.

deceive or defraud, a penalty of $20,000, 5 years imprisonment or both follows. However, if the contravention has occurred in the absence of fraudulent intent, then a lesser penalty of $5,000 applies. Adopting a similar approach in the context of market manipulation, the full criminal penalty under the existing offence would remain for truly criminal market manipulation with the requisite intention. However, a lesser penalty would automatically be imposed in respect of conduct falling within the specified list of prohibited conduct, regardless of intention, and by virtue of the act itself. Here, an absolute prohibition is imposed upon proscribed types of conduct, with an automatic fine imposed for infringement, yet retaining the possibility of full criminal sanctioning where appropriate. In this way, the sanctions would reflect the distinction between intentional and non-intentional market manipulation, with a dual system of penalties imposed according to the respective level of culpability involved.

However, the Anisman Committee Report stated that "it is possible, in fact likely, that persons often trade in securities for a legitimate purpose in circumstances where it is reasonable to believe their trades will induce others to trade."[218] It may therefore be necessary to include some element of intent in the prohibition to avoid the "dangers of convicting the innocent".[219] Market manipulation in its conventional sense depends on the relevant state of mind of its perpetrator, and to exclude all consideration of intention may thus prove unjust. The case of *Tuckwell*

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[218] *Proposals for a Securities Market Law for Canada* (Ministry of Supply and Services Canada, 1979) The Anisman Committee Report, Commentary at 228.

[219] Andrews, "Mens Rea and Insider Trading: Does s 128 of the Securities Industry Code say what it means or does it mean what it says?" Paper delivered at DPP Corporate Prosecutors Conference (Qld, August 1992) p10.

shows that trading activity which may appear to be manipulative may in fact have an innocent explanation. There is a fine line between manipulative conduct and legitimate trading activity, and allowing for some degree of mens rea may be a necessary safeguard against penalising trading activity which is merely unusual.

A further alternative, therefore, would be to impose an offence of strict liability, but allowing for a limited defence where it can be established that the defendant had no reason to suspect that his conduct would mislead the market in any way. A similar approach is evident in s47(a) *Financial Services Act* (UK) 1986. There it is a defence to a charge of engaging in a course of conduct with the purpose of creating a false or misleading impression of the market in or price of investments, if it can be shown that the accused reasonably believed their act would not create a false or misleading impression. Note that the defence is expressed in terms of the accused's belief as to the effects of their conduct upon the market, and not their purpose in so acting. A defence of this nature would be far more restrictive in its operation than that currently provided by ss998(6) and 998(8) in relation to wash sales and matched orders. In order to make out a successful defence under the current sections, it is necessary only to establish that it was not the purpose of the conduct to create "a false or misleading appearance of active trading in a stockmarket."

In shifting the focus from the 'purpose' of the defendant's acts to their state of knowledge as to the likely effects of their conduct, the market would be afforded a greater degree of protection against manipulative activity in respect of which a motive to manipulate cannot necessarily be defined. Thus our hypothetical trader, although perhaps not entering wash sale transactions for the 'purpose' of

manipulating the market, would surely have realised that this would be a likely effect of their conduct, which would thus be illegal. Similarly, Tuckwell, in placing illusory bids at the close of trading, would find it far more difficult to assert that he had no reason to suspect that this would have the effect of misleading the market, than he had in rebutting an intention to manipulate the market as such.

Another option would be to reverse the onus of proof. There the prosecution need only establish the existence of certain objective facts , at which point the onus shifts to the accused to prove their innocence. This approach is illustrated by s341 of the *Canadian Criminal Code*. It is an offence under this section to make a contract or agreement to purchase or sell shares without possessing the bona fide intention of acquiring or selling them. Where it is established that the accused in fact entered a contract for the sale or purchase of stock, then the burden of proving a bona fide intention to acquire or sell the shares lies upon the accused. On this approach, the burden of proof is effectively shifted from the prosecution to the defendant. Upon the prosecution establishing the relevant objective trading activity, the onus would then shift to the defendant to prove that they did not possess the requisite intention to manipulate the market. Reversing the burden of proof in this way is a recognition of the prohibitive difficulty of establishing the requisite manipulative intention beyond reasonable doubt, whilst retaining at least some degree of mens rea nevertheless.

Reversal of the onus of proof is said to be justified where matters to be raised in defence fall particularly within the knowledge of the accused, and it would prove

extremely costly for the prosecution to be required to negate them.[220] In the context of insider trading, the Griffiths Committee noted that it is extremely difficult for the prosecution to define the requisite intention, but comparitively easy for the defence to raise a defence of legitimate trading: "these elements are very difficult for the prosecution to prove, but comparatively easy for the defence to disprove, because they relate to matters within the defendant's sphere of knowledge."[221] Similar arguments could be asserted in respect of market manipulation. However, the Griffith Committee noted considerable opposition to the proposal on grounds that there was no reason to "abandon basic principles of Australia's legal system" that a person is innocent until proven guilty merely in order to "achieve more convictions."[222] As a result, the Committee chose not to support proposals for reversing the onus of proof in respect of insider trading, preferring instead to clarify the existing provisions, removing some of the more onerous elements of proof.[223]

Whatever the precise form of sanctioning adopted, the principal concern is that the existing criminal position is ultimately strengthened, expanded and clarified by the addition of an objective category of prohibited conduct, imposing a lesser penalty of some kind for its infringement. The expanded criminal approach so created is then complemented by the broad range of civil sanctions, as discussed in chapter 9.3.3.

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[220] Griffiths Report, at 4.10.3.
[221] At 4.10.7.
[222] At 4.10.8.
[223] At 4.10.9.

10.4. Redressing shortfalls in the existing provisions

In addition to broadening the scope of the criminal law in this area, the existing criminal offence of market manipulation as contained in ss997, 998 requires significant clarification in order to increase its effectiveness as a criminal sanction.[224] The provisions currently present an unwieldy array of sections and subsections, unnecessarily obscuring the need for a clear and decisive regulatory direction.

The Attorney General, Michael Duffy, has stated that it is essential "that penalties in respect of white collar offences, especially corporations and securities offences, should properly reflect the serious effect that those offences have on the integrity of, and public confidence in, Australia's financial markets."[225] The seriousness of the offence of insider trading would appear to equate with that of market manipulation. Each exhibits an intention to defraud the market in some way, and significantly threatens market integrity. However, the pecuniary penalty for insider trading in breach of s1002 is ten times[226] that provided for breach of ss997,998. There can be no logical explanation for the extent of the discrepancy and I would submit that the penalty for market manipulation should be similarly increased to reflect the seriousness of the offence.

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224 As discussed chapter 4.4. above.

225 Duffy, Government Response to the Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs entitled *Fair Shares for All: Insider Trading in Australia* (Oct 1990) 10.

226 Penalty of up to $200,000 and/or 5 years imprisonment for breach of insider trading provision s1002: Sch 3.

CONCLUSION

The Australian legislation in respect of market manipulation has failed to achieve the regulatory objectives of market fairness and confidence in the integrity of the Australian securities industry. Recent developments in surveillance technology and investigatory capacity will dramatically improve the rate of detection of manipulative conduct in the market. However, it is submitted that the current regulatory problem facing the Australian securities industry is more fundamental and can be largely traced to the provisions themselves. The current inadequacies of the criminal law in respect of market misconduct of this kind have rendered its use prohibitive, promoting increased reliance on civil sanctions by the ASC and aggravating regulatory tension between the ASC and DPP. It is submitted that a strong line of criminal enforcement must be developed to maintain and strengthen the viability of the Australian securities industry. To this end, an expanded criminal law approach is advocated, increasing regulatory scope and effectiveness, and guarding more fully against artificial forces in the marketplace.

It is hoped that this thesis will encourage greater recognition of the extent of the threat to market integrity posed by the continued incidence of market manipulation in the Australian securities industry, and that its effective regulation will at last be accorded the priority it so deserves.

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