

# **REFORMING THE REGULATION OF FINANCIAL MARKET MANIPULATION**

**BY**

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## ABSTRACT

Fraudsters periodically attempt to enrich themselves by employing a raft of tricks and schemes to exploit investors and financial markets. Market manipulation (‘manipulation’) is one such class of illegitimate conduct. It perverts the market price formation process and undermines public confidence in financial market integrity. An effective prohibition on manipulation is thus required to protect investors from fraud and promote market integrity, thereby fostering investment and economic growth.

Chapter 1 of this thesis defines manipulation and argues that the current anti-manipulation regime, ss 1041A–1041C of the *Corporations Act 2001* (Cth), requires substantive reform. This regime is predicated on a conceptually unsound understanding of manipulation. It fails to articulate the nature and role of manipulative intention and is based on an unclear distinction between civil penalties and criminal offences. As such, the scope of liability is sometimes too broad and at other times too narrow. Additionally, the provisions are internally defective, as they suffer from ambiguous language. They are also overly complex and have inconsistent physical and fault requirements. The *Criminal Code Act 1995* (Cth) exacerbates these problems.

Chapter 2 advances a two-pronged proposal for substantive law reform. Principally, two criminal prohibitions on manipulation should replace the current regime. These will prohibit a person from executing a transaction, or doing, or omitting to do, an act, when motivated by the dominant purpose of manipulating the market for, or price of, a financial product. The provisions clearly articulate the requisite manipulative intention and have an appropriate scope of liability. They are also easier to enforce than the current regime, as two deeming provisions facilitate proof of manipulative intention.

The proposed regime is complemented by a *Serious Financial Market Crimes Act 2014* (Cth). This contains prohibitions on manipulation and other conduct that undermines financial market integrity, reinforcing the serious criminal nature of manipulation and enhancing the credibility of ASIC's enforcement actions. It may also motivate Parliament to articulate its policy objectives in greater detail. Together, these proposals would effectively deter manipulation and promote financial market integrity.

## INTRODUCTION

Because they play a central role in the economy, financial markets affect the standard of living of all Australians.<sup>1</sup> They drive capital investment and economic growth, thereby supporting job creation, fostering business confidence and stimulating increased production. Most working-age Australians indirectly own shares through their superannuation fund, the value of which is determined by the performance of financial markets. Financial markets also perform less visible, but equally important, functions. They enable companies to raise capital, facilitate the pricing and transfer of financial products, and allow financial risk to be hedged.<sup>2</sup>

These economic benefits are maximised if the price of listed securities is determined by the fair, transparent and competitive interplay of market forces in an efficient market.<sup>3</sup> At the same time, fraudsters have an immense profit incentive to use manipulative schemes to pervert the market price and exploit market processes. Tomes of ingenious manipulative techniques fill the academic literature, cataloguing the vast array of schemes designed to improperly exploit prevailing market structures, regulation and technology.

The public interest strongly favours a robust prohibition on manipulation that protects investors from fraud and facilitates the fair and competitive interplay of market forces. Any such prohibition must not be overly broad, as this would deter socially beneficial trading activity and stifle financial market innovation.

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<sup>1</sup> Paul Constable, 'Ferocious Beast or Toothless Tiger? The Regulation of Stock Market Manipulation in Australia' (2011) 8 *Macquarie Journal of Business Law* 54, 78.

<sup>2</sup> Gordon Walker and Brent Fisse, *Securities Regulation in Australia and New Zealand* (Oxford University Press, 1st ed, 1995) 103.

<sup>3</sup> *Ibid* 133–34.

Modern Australian financial markets are highly regulated and generally perceived as fair and efficient.<sup>4</sup> However, in the last few years, the adequacy of the current anti-manipulation regime, ss 1041A–1041C of the *Corporations Act 2001* (Cth), has been challenged. The sensational market abuses of the global financial crisis have highlighted the perennial risk of widespread and sophisticated manipulation. This risk will continue to increase,<sup>5</sup> enabled by changing market structures, technology, the identity of market participants, and the global interconnectedness of capital markets.<sup>6</sup> As such, it is crucial that the prohibition on manipulation is conceptually sound, has an appropriate scope of liability, and is sufficiently flexible to remain effective in response to changing circumstances.

This thesis builds on the existing academic literature by providing a sustained criticism of the current anti-manipulation regime and proposing a model for substantive law reform. The scope of the thesis is limited to manipulation by transactions, acts and omissions.

Manipulation by false or misleading statements is not considered, as this raises different issues and such statements are extensively regulated independent of them being manipulative.<sup>7</sup>

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<sup>4</sup> Australian Securities and Investments Commission ('ASIC') Chairman Tony D'Aloisio, 'Insider Trading and Market Manipulation' (Speech delivered at the Supreme Court of Victoria Law Conference, Melbourne, 13 August 2010) 5–6.

<sup>5</sup> Constable, 'Ferocious Beast', above n 1, 63; Ian Tunstall, *International Securities Regulation* (Thomson Reuters, 1st ed, 2005) 148.

<sup>6</sup> Mark McGinness, 'Regulatory Models for Protecting the Markets: An Australian Perspective' (2001) 9 *Journal of Financial Crime* 40, 51; Steve Thel, '\$850,000 in Six Minutes — The Mechanics of Securities Manipulation' (1994) 79 *Cornell Law Review* 219, 240.

<sup>7</sup> Corporations and Markets Advisory Committee, 'Aspects of Market Integrity' (Report, June 2009) 7, 10; *Corporations Act 2001* (Cth) ss 1041E, 1041H. For a recent example, see ASIC, 'Criminal Charge against Jonathan Moylan' (Media Release, 13-187MR, 23 July 2013).

Practical reforms to evidence-gathering powers, trial procedures and sentencing will play an important role in the practical effectiveness of the proposed regime. However, they are beyond the scope of this thesis.

Chapter 1 mounts the case for substantive law reform by assessing the conceptual soundness and effectiveness of the current regime. This analysis is necessarily detailed and technical, reflecting the complexity of the issues and the practical application of the current provisions. Chapter 2 advances two proposals for substantive law reform, providing a detailed discussion of each proposal and its benefits.

## CHAPTER 1: THE CURRENT STATE OF PLAY

The Australian Securities and Investments Commission ('ASIC') has an ongoing responsibility to protect Australian financial markets from manipulation. This requires ASIC to use innovative detection and enforcement methods to keep pace with the constantly evolving raft of manipulative schemes. A robust prohibition on manipulation must underpin this fight and is critical to successful enforcement actions. Unfortunately, as will be shown, the current anti-manipulation regime is conceptually unsound and ineffective. A case will be made that substantive law reform is required to equip ASIC with the tools to combat manipulation and effectively protect financial markets and investors.

### *A Definition of Financial Market Manipulation*

The definition of manipulation and its precise scope are in a contested state of flux.<sup>8</sup>

However, for the purpose of this thesis, it is sufficient to highlight several core features.

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<sup>8</sup> See generally Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (LexisNexis Butterworths, 8th ed, 2012) 652; Hui Huang, 'Redefining Market Manipulation in Australia: The Role of an Implied Intent Element' (2009) 27 *Company and Securities Law Journal* 8, 14; Daniel R Fischel and David J Ross, 'Should the Law Prohibit "Manipulation" in Financial Markets?' (1991) 105 *Harvard Law Review* 503, 506–10; William D Harrington, 'The Manipulation of Commodity Futures Prices' (1981) 55 *St John's Law Review* 240, 248; David C Donald, 'Regulating Market Manipulation through an Understanding of Price Creation' (2011) 6 *National Taiwan University Law Review* 55, 64; Robert A Jarrow, 'Market Manipulation, Bubbles, Corners, and Short Squeezes' (1992) 27 *Journal of Financial and Quantitative Analysis* 311, 312; Emiliós E Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis* (Oxford University Press, 1st ed, 2005) 116; Eva Lomnicka, 'Preventing and Controlling the Manipulation of Financial Markets: Towards a Definition of "Market Manipulation"' (2001) 8 *Journal of Financial Crime* 297, 298; Matthijs Nelemans, 'Redefining Trade-Based Market Manipulation' (Discussion Paper, Tilburg University, January 2008) 12 <<http://ssrn.com/abstract=1078423>>; Wendy Collins Perdue, 'Manipulation of Futures Markets: Redefining the Offense' (1987) 56 *Fordham Law Review* 345, 348; Vivien R Goldwasser, *Stock Market Manipulation and Short Selling* (CCH Australia and Centre for Corporate and Securities Regulation, Faculty of Law, University of Melbourne, 1st ed, 1999) 99–102.

Manipulation is a class of illegitimate conduct comprising a variety of techniques. It perverts the market price formation process and thus undermines financial market integrity.<sup>9</sup>

Fundamentally, as Justice Mason noted in his seminal judgment in *North v Marra Developments* (1981), manipulation causes the market price to reflect the manipulator's concerted efforts.<sup>10</sup> It ceases to be the product of the free and competitive interplay of the forces of genuine supply and demand.<sup>11</sup> More precisely, manipulation perverts the price formation process by setting, maintaining or causing an unjustified change in the market price, introducing false information into the market, or creating a false or misleading appearance of genuine trading activity.<sup>12</sup>

Persons who detrimentally trade, or refrain from trading, due to manipulation are directly harmed.<sup>13</sup> So too are persons who realise an asset, or trigger a contractual obligation, on less advantageous terms than if manipulation had not occurred.<sup>14</sup> Manipulation of a company's share price may also place pressure on that company.<sup>15</sup> All market participants are indirectly harmed by reduced price efficiency, wider bid–ask spreads<sup>16</sup> and lower liquidity.<sup>17</sup> More

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<sup>9</sup> Avgouleas, above n 8, 155; Ministry of Economic Development of New Zealand, 'Reform of Securities Trading Law: Market Manipulation Law' (Discussion Document, May 2002) 17, 35; Donald, above n 8, 64.

<sup>10</sup> *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

<sup>11</sup> *Ibid.*

<sup>12</sup> Avgouleas, above n 8, ch 4; Paul Latimer, 'False Trading and Market Rigging on the Stock Exchange' (1999) 7 *Asia Pacific Law Review* 247, 247–48.

<sup>13</sup> Ahmad Alkhamees, 'Private Action as a Remedy against Market Manipulation in the USA' (2012) 20 *Journal of Financial Regulation and Compliance* 41, 43; Arthur F Mathews, *Securities Litigation under the Federal Securities Laws* (Practicing Law Institute, 1977) vol 1, 376; *R v Chan* (2010) 79 ACSR 189, 194 [22].

<sup>14</sup> Thel, '\$850,000 in Six Minutes', above n 6, 232–34; *R v Chan* (2010) 79 ACSR 189, 194 [22].

<sup>15</sup> Constable, 'Ferocious Beast', above n 1, 79.

<sup>16</sup> Rebecca Söderström, 'Regulating Market Manipulation: An Approach to Designing Regulatory Principles' (Working Paper, Uppsala Faculty of Law, 2011) 8, 10.

generally, the economy is harmed through suboptimal capital allocation.<sup>18</sup> Finally, the perceived risk of manipulation reduces public confidence in the integrity of the market price, meaning that these adverse effects may persist after the manipulation has ended.<sup>19</sup> As such, courts have recognised a strong public interest in prohibiting manipulation.<sup>20</sup>

At its core, manipulation is defined as an act, trade or omission that is carried out with a manipulative intention.<sup>21</sup> Proof of a manipulative intention is the defining feature of manipulation and is both necessary and sufficient for the act, trade or omission to be manipulative.<sup>22</sup> The nature and role of manipulative intention depend on the manipulative technique used and whether the manipulator targets the ‘market price’ or the ‘market’.

The ‘market price’ can be targeted directly or, for a derivative contract (such as a future), by manipulating the underlying asset. It is sufficient that the manipulator intended to set or maintain, or cause an unjustified change in, the market price of the financial product or, for a derivative contract, the underlying asset.<sup>23</sup> For example, a trader might buy securities for the

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<sup>17</sup> ASIC Commissioner Belinda Gibson, ‘Improving Confidence and Integrity in Australia’s Capital Markets’ (Speech delivered at the Committee for Economic Development of Australia, Sydney, 8 July 2008) 3.

<sup>18</sup> Tunstall, above n 5, 186; D’Aloisio, ‘Insider Trading’, above n 4, 3–4.

<sup>19</sup> D’Aloisio, ‘Insider Trading’, above n 4, 3–4.

<sup>20</sup> *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

<sup>21</sup> Avgouleas, above n 8, ch 4.

<sup>22</sup> Fischel and Ross, above n 8, 506, 510; Goldwasser, *Stock Market Manipulation*, above n 8, 110; Huang, above n 8, 16–18.

<sup>23</sup> Avgouleas, above n 8, ch 4.

dominant purpose of ensuring that the day's closing price for the security does not fall below the level at which a margin lender will require additional capital on a margin loan.<sup>24</sup>

There are several ways to target the 'market'. Most commonly, this occurs when the manipulator intends to create a false or misleading appearance of genuine trading activity.<sup>25</sup> For example, a group of persons might repeatedly trade a security between themselves to falsely simulate the appearance of trading activity.<sup>26</sup> Other characteristics of the market, such as liquidity, can also be manipulated. This might occur if a manipulator withholds shares from the market with the intention of constraining liquidity.<sup>27</sup> Finally, a manipulator may intentionally interfere with the market price formation process, such as by flooding the market with bids or offers with the intention of cancelling them before execution to slow the price formation process.<sup>28</sup>

Many common manipulative techniques are readily identifiable.<sup>29</sup> For illustrative purposes, two of them — wash sales and marking the close — are described below.

A wash sale occurs when a person simultaneously offers to sell and buy a security that they already own. Thus, while a trade is reported to have occurred, there is no change in beneficial

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<sup>24</sup> Facts based on *DPP (Cth) v JM* (2013) 87 ALJR 836, 839 [4]–[7].

<sup>25</sup> *Braysich v The Queen* (2011) 243 CLR 434, 470 [97] (Bell J dissent, Heydon J agreeing); *Braysich v The Queen* (2009) 260 ALR 719, 726 [26], 739 [77].

<sup>26</sup> Paul Redmond, *Corporations and Financial Markets Law* (Thomson Reuters, 6th ed, 2013) 922–23.

<sup>27</sup> Ashley Black, 'Regulating Market Manipulation: Sections 997–999 of the Corporations Law' (1996) 70 *Australian Law Journal* 987, 995.

<sup>28</sup> Matt Prewitt, 'High-Frequency Trading: Should Regulators Do More' (2012) 19 *Michigan Telecommunications and Technology Law Review* 131, 147–48.

<sup>29</sup> Appendix 1 defines common manipulative techniques.

ownership in the security.<sup>30</sup> This creates a false or misleading appearance of trading activity, which is intended to mislead investors about the level of market demand for the security.<sup>31</sup> This might induce investors to detrimentally purchase or sell the security at manipulated volumes or prices.<sup>32</sup> Wash sales are themselves manipulative and may also be part of complex manipulative schemes. For example, a manipulator could execute wash sales at increasing prices to falsely simulate buying activity. This may induce genuine buyers to enter the market, thereby exacerbating the price trend and allowing the manipulator to profit.<sup>33</sup>

Marking the close occurs when a person makes bids or buys shares at or near the close of trading for the purpose of achieving a specific closing price.<sup>34</sup> The market price then reflects the manipulator's concerted effort, rather than the forces of genuine supply and demand.<sup>35</sup> This may be done to trigger on more beneficial terms a contractual right, such as a futures contract or contractual performance bonus, that is tied to the price of the manipulated security.<sup>36</sup> For example, a fund manager might bid up the price of securities at the end of the quarter to inflate the performance of their investment portfolio and so earn a higher commission.<sup>37</sup>

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<sup>30</sup> Redmond, above n 26, 922–23.

<sup>31</sup> Avgouleas, above n 8, 127.

<sup>32</sup> Constable, 'Ferocious Beast', above n 1, 76; Eugene V Rostow, 'Market Manipulation and the Securities Exchange Act' (1937) 46 *Yale Law Journal* 624, 626–29, 636.

<sup>33</sup> Explanatory Memorandum, Corporations Amendment (Financial Market Supervision) Bill 2010 (Cth) 63.

<sup>34</sup> Redmond, above n 26, 922–23.

<sup>35</sup> Vivien R Goldwasser, 'Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales' (1999) 5 *Australian Journal of Legal History* 149, 179.

<sup>36</sup> Thel, '\$850,000 in Six Minutes', above n 6, 228–31.

<sup>37</sup> Constable, 'Ferocious Beast', above n 1, 71–72.

It is worth noting that there is ongoing peripheral debate about whether new techniques, especially those facilitated by high-frequency trading, are manipulative.<sup>38</sup> However, this question is beyond the scope of the thesis.

## **B Assessment of the Current Anti-Manipulation Regime**

Having defined manipulation, attention now turns to whether it is effectively prohibited by the current regime. This section of the thesis provides an overview of ss 1041A–1041C of the *Corporations Act 2001* (Cth), followed by a detailed analysis of each provision, before considering the application of the *Criminal Code Act 1995* (Cth) and the civil penalty/criminal offence distinction.

### **1 Overview of the Anti-Manipulation Prohibitions**

The current regime comprises three independent prohibitions that are not to be read down by reference to each other.<sup>39</sup> They provide that a person must not:

- (i) take part in, or carry out (whether directly or indirectly), a *transaction or transactions* that (ii) have, or are likely to have, the effect of creating or maintaining an *artificial price* for trading in a financial product: s 1041A;
- (i) do, or omit to do, an act if that *act or omission* (ii) has, or is likely to have, the effect of creating, or causing the creation of, a *false or misleading appearance* of<sup>40</sup> (iii) active

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<sup>38</sup> Eugene Clark, ‘The Legal Tortoise and the High Frequency Trading Hare: The Challenge for Regulators’ (2011) 25 *Australian Journal of Corporate Law* 274, 291–92; Söderström, above n 16, 20; ASIC Commissioner Shane Tregillis, ‘Dark Pools, HFT and Competition’ (Speech delivered at the Stockbrokers Association of Australia Conference 2011, Sydney, 26 May 2011) 10–11.

<sup>39</sup> *Corporations Act 2001* (Cth) s 1041J.

trading in financial products<sup>41</sup> or (iv) with respect to the market for financial products or (v) with respect to the price for trading in financial products:<sup>42</sup> s 1041B(1); or

- (i) enter into, or engage in, a *fictitious or artificial transaction or device* if that transaction or device (ii) *results in the price* for trading in a financial product *fluctuating*,<sup>43</sup> or being *maintained, inflated or depressed*: s 1041C(1).

Each prohibition is a financial services civil penalty provision<sup>44</sup> and a criminal offence. To establish a civil penalty contravention, ASIC must prove, on the balance of probabilities,<sup>45</sup> the physical elements specified above by the roman numerals. To establish a criminal offence, the Commonwealth Director of Public Prosecutions must prove, beyond reasonable doubt,<sup>46</sup> the physical elements and corresponding fault elements implied by the *Criminal Code Act 1995 (Cth)*.<sup>47</sup> The maximum penalty for an individual for civil penalty contravention is a \$200,000 pecuniary penalty order<sup>48</sup> and for criminal contravention is 10 years' imprisonment and/or a fine of the greater of \$450,000 or three times the value of the benefit reasonably attributable to the offence.<sup>49</sup>

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<sup>40</sup> The proscribed effects are alternatives: *Australian Securities Commission v Nomura International Plc* (1998) 89 FCR 301, 367.

<sup>41</sup> *Corporations Act 2001* (Cth) s 1041B(1)(a).

<sup>42</sup> *Ibid* s 1041B(1)(b).

<sup>43</sup> *Ibid* s 1041C(1)(b).

<sup>44</sup> *Ibid* ss 1317E, 1317S.

<sup>45</sup> *Ibid* ss 1317L, 1322.

<sup>46</sup> *Criminal Code Act 1995* (Cth) sch 1 s 13.2(1).

<sup>47</sup> *Corporations Act 2001* (Cth) s 1308A; *Criminal Code Act 1995* (Cth) sch 1 s 5.6.

<sup>48</sup> *Corporations Act 2001* (Cth) ss 1317E, 1317G(1A), 1317G(1B).

<sup>49</sup> *Ibid* ss 1311(1), 1311(3), sch 3 item 310.

It is also prohibited for a person to spread information about the occurrence of a manipulation where that person or their associate has committed the manipulation or would benefit from spreading the information.<sup>50</sup> This is intended to limit the harm caused by manipulation.

Before considering the sections in detail, three points should be noted. First, the sections apply to a ‘person’.<sup>51</sup> This includes natural persons and corporations,<sup>52</sup> and is not limited to registered market participants. Second, the conduct must affect a financial product on a financial market<sup>53</sup> operated in Australia.<sup>54</sup> It does not matter where the manipulator is located or the impugned acts take place. Third, the sections apply uniformly to securities and futures markets, as the definition of financial product expressly includes securities<sup>55</sup> and futures.<sup>56</sup>

## ***2 Critique of ss 1041A and 1041B***

Section 1041A prohibits a person from (i) taking part in, or carrying out (whether directly or indirectly), a *transaction or transactions* that (ii) have, or are likely to have, the effect of creating or maintaining an artificial price for trading in a financial product.<sup>57</sup> ‘Transaction’ means an act or doing, negotiating or dealing with something or ‘an affair, a piece of

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<sup>50</sup> Ibid s 1041D.

<sup>51</sup> Ibid ss 1041A–1041D.

<sup>52</sup> *Acts Interpretation Act 1901* (Cth) ss 2, 2C.

<sup>53</sup> Financial market is defined in *Corporations Act 2001* (Cth) s 767A(1). It excludes over-the-counter markets (parties negotiate transactions directly) and dark pools (markets without pre-trade price transparency): *Corporations Act 2001* (Cth) s 767A(2); Baxt, Black and Hanrahan, above n 8, ch 10.

<sup>54</sup> *Corporations Act 2001* (Cth) ss 5, 1041A–1041C.

<sup>55</sup> Ibid s 764A(1)(a).

<sup>56</sup> Ibid ss 764(1)(c), 761D.

<sup>57</sup> Ibid s 1041A.

business'.<sup>58</sup> This includes a legally enforceable transaction,<sup>59</sup> placing a bid or offer, and instructing a broker or agent to place a bid or offer, irrespective of whether it is executed.<sup>60</sup>

Section 1041B(1) prohibits a person from (i) doing, or omitting to do, an act if that *act* or *omission* (ii) has, or is likely to have, the effect of creating, or causing the creation of, a *false or misleading appearance* of (iii) active trading in financial products<sup>61</sup> or (iv) with respect to the market for financial products or (v) with respect to the price for trading in financial products.<sup>62</sup> 'Act or omission' encompasses any conduct capable of having the prohibited effect, whether occurring on-market or not.<sup>63</sup> This includes a statement,<sup>64</sup> a transaction<sup>65</sup> or placing a bid or offer.<sup>66</sup>

These sections are defective for several reasons. First, if proof of manipulative intention is not necessary to contravene the sections, the scope of liability is too broad. Second, if engaging in conduct, or a trade, with a manipulative intention is not sufficient to contravene the sections, the scope of liability is too narrow. Third, the court's construction of artificial price and false or misleading appearance of price as dependent on manipulative intention is unconvincing and renders these concepts empty.

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<sup>58</sup> *Sparks v Berry* [2001] QSC 251 at [13].

<sup>59</sup> *Ibid.*

<sup>60</sup> *R v Manasseh* (2002) 167 FLR 44, 56 [33], 65 [57].

<sup>61</sup> *Corporations Act 2001* (Cth) s 1041B(1)(a).

<sup>62</sup> *Ibid* s 1041B(1)(b).

<sup>63</sup> *Rosenberg v Australian Securities and Investments Commission* (2010) 117 ALD 582, 600 [75].

<sup>64</sup> *Endresz v Whitehouse* (1997) 24 ACSR 208.

<sup>65</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21.

<sup>66</sup> *R v O'Halloran* (2000) 182 ALR 431, 452 [81].

***(a) Objective Effect***

Section 1041A is drafted as if artificial price is an objective effect that can be observed on the market and demonstrated to have occurred, independent of proof of manipulative intention. Commentators adopting this perspective argue that there is a strong inference that a price is artificial if the price cannot be explained based on historical price levels, trends or relationships with other assets.<sup>67</sup> It was in this vein that counsel for the respondent in *Director of Public Prosecutions (Cth) v JM* (2013)<sup>68</sup> argued, pursuant to a Victorian Supreme Court of Appeal Decision,<sup>69</sup> that an artificial price is created by abusing market power and can be objectively distinguished from a natural price by counterfactual economic analysis.<sup>70</sup>

Similarly, it might be thought that the effects proscribed by s 1041B(1) can be demonstrated by economic analysis or based on the perception of a *reasonable* market participant.<sup>71</sup>

Parliament has endorsed this view by implying that proof of intention is not necessary for civil penalty contravention<sup>72</sup> and removing ‘*intended to have*’<sup>73</sup> as a sufficient causal nexus.

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<sup>67</sup> For criticisms of this approach, see Benjamin E Kozinn, ‘Great Copper Caper: Is Market Manipulation Really a Problem in the Wake of the Sumitomo Debacle?’ (2000) 69 *Fordham Law Review* 243, 261–62; Perdue, above n 8, 367–72.

<sup>68</sup> (2013) 87 ALJR 836.

<sup>69</sup> *DPP (Cth) v JM* (2012) 267 FLR 238, 306 [309], 315–316 [333]–[335] (Nettle and Hansen JAA) held that artificial price requires the misuse of dominant market power, as typified by corners and squeezes. This was *correctly* overturned by the High Court, as it is not supported by the text, structure or purpose of the section and would give it limited scope in relation to securities: *North v Marra Developments Ltd* (1981) 148 CLR 42; *DPP (Cth) v JM* (2013) 87 ALJR 836, 848 [60], 449 [66], 850 [70].

<sup>70</sup> Transcript of Proceedings, *DPP (Cth) v JM* [2013] HCATrans 96 (8 May 2013) 3–5 (Mr Moschinsky).

<sup>71</sup> For this approach, see *Rosenberg v Australian Securities and Investments Commission* (2010) 117 ALD 582, 602 [90], 603 [95]; Avgouleas, above n 8, 108.

<sup>72</sup> Commentary on the Draft Provisions, Financial Services Reform Bill 2001 (Cth) (Treasury, February 2000) 11.10; *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 41 [80].

The possibility of objectively demonstrating a manipulative effect does not accord with the mechanics of the price formation process and, in relation to artificial price, was rejected by the High Court.<sup>74</sup> Nobody directly controls the market price. The market price is determined by matching a person's bid or offer with that of another investor, according to the rules of the price formation mechanism.<sup>75</sup> All bids and offers are objectively indistinguishable from the perspective of the market mechanism, as they are anonymous requests to buy or sell a specified volume of securities at a particular price.<sup>76</sup>

Similarly, all executed trades are objectively indistinguishable because they are the output of the same mechanism. Thus, it is inaccurate to describe a price as artificial, or an appearance of price or active trading as false or misleading, if it was produced by the market mechanism and the other party was a genuine buyer or seller. Likewise, it cannot be objectively demonstrated that a price or trading pattern caused by conduct or an omission created one of the effects proscribed by s 1041B(1).

It follows that artificial price and false or misleading appearance of price are unworkable concepts absent proof of manipulative intention. Alternatively, they are premised on an unsound belief that trading or conduct can be manipulative absent proof of a manipulative intention. This would render the scope of liability too broad. A person could wrongly be held

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<sup>73</sup> See pages 22–23.

<sup>74</sup> *DPP (Cth) v JM* (2013) 87 ALJR 836, 848–850.

<sup>75</sup> Redmond, above n 26, 868–69.

<sup>76</sup> Walker and Fisse, above n 2, 106–07.

to have manipulated the market merely because their conduct has an unusual effect that is inexplicable by reference to historical price trends.<sup>77</sup>

**(b) Causal Nexus**

The causal nexus ‘have or likely to have’<sup>78</sup> implies that engaging in conduct, or trading, with a manipulative intention is not sufficient to contravene either section. This is more restrictive than previous regimes, which provided that ‘calculated to have’<sup>79</sup> or ‘intended to have’<sup>80</sup> was sufficient for contravention. For example, the superseded futures manipulation provisions on which s 1041A is based<sup>81</sup> provided that it was sufficient to prove an *intention* to create an artificial price.<sup>82</sup>

The current sections are based on an unduly narrow belief that manipulation is only harmful if it has an actual or objectively<sup>83</sup> likely effect on the market. As will be explained, this is incorrect because manipulation is harmful even if it is unlikely to have a demonstrable effect. Indeed, a manipulative trade is unlikely to have a demonstrable effect if it is small relative to market turnover or if the market is highly liquid.<sup>84</sup>

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<sup>77</sup> Perdue, above n 8, 367–72; Alexander F H Loke, ‘The Investors’ Protected Interest against Market Manipulation in the United Kingdom, Australia and Singapore’ (2007) 21 *Australian Journal of Corporate Law* 22, 41–46.

<sup>78</sup> *Corporations Act 2001* (Cth) ss 1041A, 1041B.

<sup>79</sup> *Securities Industry Act 1970* (NSW) s 70; *Corporations Act 1989* (Cth) s 1260(1); *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

<sup>80</sup> *Corporations Act 1989* (Cth) ss 998(1)–(2), 1259; *Futures Industry Act 1986* (Cth) s 130.

<sup>81</sup> Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) 15.12.

<sup>82</sup> *Corporations Act 1989* (Cth) s 1259; *Futures Industry Act 1986* (Cth) s 130.

<sup>83</sup> *Donald v Australian Securities and Investments Commission* (2000) 104 FCR 126, 135 [25]–[27]; *Australian Securities Commission v Nomura International Plc* (1998) 89 FCR 301, 371.

<sup>84</sup> Donald, above n 8, 77–78.

A trade executed with a manipulative intention introduces into the market false information about the level of supply and demand. This undermines the integrity of the market price, irrespective of whether the market price or trading volumes are demonstrably affected. The price formation process treats a bid or offer as a signal of supply or demand for the security. When a manipulator enters a bid or offer with a manipulative intention, they introduce into the price formation process information about the level of demand and supply that they *subjectively know* to be false. The process incorrectly treats the bid or offer as reflecting genuine demand and supply and so is adversely affected.

If conduct entered into with a manipulative intention affects the market price or investor valuations of the security, then it can be analysed in the same way. If it does not have such an effect, then it can be described as a *conspiracy* to manipulate the market. The conspiracy is complete and the manipulator has done all that is within their control to manipulate the market when they engage in conduct to pursue their manipulative intention.<sup>85</sup> Consequently, liability for manipulation should not arbitrarily depend on the conduct having a demonstrable effect. More significant is that the maintenance of public confidence in the integrity of the market price requires that this conduct be prohibited.

### ***(c) Manipulative Intention***

Courts have tried to overcome these problems by emphasising the role of manipulative intention.<sup>86</sup> Artificial price has been characterised by contrasting it with a price brought about

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<sup>85</sup> *R v De Berenger* (1814) 105 Eng Rep 534, 539; *Scott v Brown, Doering, McNab & Co* [1892] 2 QB 724, 728–30.

<sup>86</sup> *R v O'Halloran* (2000) 182 ALR 431, 451 [78]; *Musumeci v Australian Securities and Investments Commission* (2009) 109 ALD 677, 687 [55]; *R v Chan* (2010) 79 ACSR 189, 194 [22]; *R v Manasseh* (2002) 167 FLR 44, 57 [36]; *Braysich v The Queen* (2009) 260 ALR 719, 744 [101]; *Australian*

by the forces of ‘genuine supply and demand’.<sup>87</sup> In *Director of Public Prosecutions (Cth) v JM* (2013)<sup>88</sup> — a decision substantially consistent with earlier authority<sup>89</sup> — it was held that when a buyer or seller conducts an on-market ASX transaction with the sole or dominant purpose of setting or maintaining the price of a listed security, such conduct is, as a matter of law, *likely* to have the effect of creating an artificial price.<sup>90</sup>

Similarly, based on the ‘genuine supply and demand’ framework, it has been held that where a person trades with the sole or dominant intention of setting or maintaining the price of a security, their conduct is, as a matter of law, *likely* to create a false or misleading appearance with respect to the market for, or price of, the security.<sup>91</sup> Also, a person who intends to create a false or misleading appearance of trading activity will come within s 1041B(1), as it will be interpreted as *likely* to create a false or misleading appearance of ‘active trading’ or with respect to the ‘market for’ a financial product.<sup>92</sup>

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*Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [90]; *Donald v Australian Securities and Investments Commission* (2000) 104 FCR 126, 134 [22].

<sup>87</sup> *DPP (Cth) v JM* (2013) 87 ALJR 836, 850 [72], [74]; *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [90], 44 [93]; *Bond v Australian Securities and Investments Commission* (2009) 108 ALD 187, 195 [36]; *North v Marra Developments Ltd* (1981) 148 CLR 42, 59; *Fame Decorator Agencies Pty Ltd v Jeffries Industries Ltd* (1998) 28 ACSR 58, 62–63.

<sup>88</sup> (2013) 87 ALJR 836.

<sup>89</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [90], 44 [93]; *Australian Securities and Investments Commission v Administrative Appeals Tribunal* (2010) 187 FCR 334, 350 [48]–[50].

<sup>90</sup> *DPP (Cth) v JM* (2013) 87 ALJR 836, 850 [71], 851 [75].

<sup>91</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [90], 44 [93]; *Fame Decorator Agencies Pty Ltd v Jeffries Industries Ltd* (1998) 28 ACSR 58, 62–63; *Australian Securities Commission v Nomura International Plc* (1998) 89 FCR 301, 368.

<sup>92</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [90], 44 [93].

Courts have reasoned that on-market ASX transactions are made openly and investors are entitled to assume that transactions are made between genuine buyers and sellers — in particular, that they are not made for the purpose of setting or maintaining the market price.<sup>93</sup>

A transaction involving such a purpose is not made between genuine buyers and sellers because it would not have been executed but for the manipulative intention.<sup>94</sup> Such a transaction is wrongly seen as reflecting genuine market forces and so has an impact on the market,<sup>95</sup> creating an artificial price<sup>96</sup> or a false or misleading appearance of price.<sup>97</sup>

The forces of ‘genuine supply and demand’ comprise buyers trying to buy financial products at the lowest available price and sellers trying to sell financial products at the highest realisable price.<sup>98</sup> This does not mean that traders must always seek the most economically advantageous price or that they cannot legitimately disagree on the value of the security.<sup>99</sup> Traders may legitimately make purchases or sales with ‘indirect or collateral motives, in circumstances where the transaction will, to the knowledge of the participants, have an effect on the market for, or price of, shares’,<sup>100</sup> and markets may ‘suffer from a variety of

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<sup>93</sup> *DPP (Cth) v JM* (2013) 87 ALJR 836, 850 [72], [74].

<sup>94</sup> *Ibid* 850 [72]; *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 44 [95].

<sup>95</sup> *DPP (Cth) v JM* (2013) 87 ALJR 836, 850 [74].

<sup>96</sup> *Ibid* 850 [72].

<sup>97</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [90], 44 [93]; *Fame Decorator Agencies Pty Ltd v Jeffries Industries Ltd* (1998) 28 ACSR 58, 62–63.

<sup>98</sup> *DPP (Cth) v JM* (2013) 87 ALJR 836, 850 [71]; *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43 [91]; *Australian Securities and Investments Commission v Administrative Appeals Tribunal* (2010) 187 FCR 334, 350 [50].

<sup>99</sup> Ashley Black, ‘Insider Trading and Market Misconduct’ (2011) 29 *Company and Securities Law Journal* 313, 323.

<sup>100</sup> *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

imperfections, including mismatches of information, without such imperfections destroying their integrity'.<sup>101</sup>

Unfortunately, the 'genuine supply and demand' analysis fails to explain why traders with certain intentions are non-genuine, and why their conduct is *likely* to have the proscribed effect. At most, it clarifies that certain trading attitudes and techniques, which might have been thought to be manipulative, are not. It follows that it is not manipulative to execute a trade that has a price impact,<sup>102</sup> value a security differently from other investors by considering idiosyncratic factors or employing a different valuation method;<sup>103</sup> or buy at a premium or sell at below market price because of legitimate collateral motives, such as an urgent need for liquidity or stake-building to launch a takeover.<sup>104</sup>

These observations do not explain what renders a trader non-genuine. The mere fact that a trader does not have the attitudes or use the techniques noted above is not a basis to infer that they had a manipulative intention. More fundamentally, the distinction between legitimate and illegitimate collateral motives is illusory because an illegitimate collateral motive is actually a manipulative intention. Effectively, courts have asserted that a trader with the intention of setting or maintaining the price of a security is not a genuine trader.<sup>105</sup> This is circular, as it is based on the prior conclusion that the trader's intention is manipulative, and the characterisation of this intention as manipulative is not explained by the 'genuine supply

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<sup>101</sup> *Fame Decorator Agencies Pty Ltd v Jeffries Industries Ltd* (1998) 28 ACSR 58, 62.

<sup>102</sup> *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

<sup>103</sup> *Fame Decorator Agencies Pty Ltd v Jeffries Industries Ltd* (1998) 28 ACSR 58, 62–63; *Australian Securities Commission v Nomura International Plc* (1998) 89 FCR 301, 326.

<sup>104</sup> *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

<sup>105</sup> *Ibid.*

and demand' framework. To say that a trader with the proscribed intention is non-genuine is to say nothing more than that trading with a manipulative intention is prohibited.

The explanation that a trade involving a non-genuine buyer or seller is *likely* to create an artificial price, or false or misleading appearance of price, is also unconvincing. Courts have reasoned that investors misperceive such trades as being the result of genuine market forces.<sup>106</sup> This assumes that investors perceive trades as only reflecting genuine market forces. They might actually recognise that some trades are strategic, or illegitimate, or they might not consider the motivation of other traders. Furthermore, it is unclear on what basis traders are entitled to assume that other traders have legitimate motivations, as the law neither requires traders to disclose their motivations nor makes it illegal to trade with a price impact.<sup>107</sup> A more convincing explanation is that such a trade is harmful because it introduces *subjectively* false information into the price formation process.<sup>108</sup> This does not require an assumption about an investor's perceptions and recognises that harm is caused at the moment the trade is executed.

Even if courts were to adopt the more moderate position that trading with the sole or dominant intention of setting or maintaining the price of a security is *sometimes likely* to have the proscribed effect, the scope of liability would be too narrow. As explained above, trading

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<sup>106</sup> Ibid.

<sup>107</sup> Steve Thel, 'Regulation of Manipulation under Section 10(b): Securities Prices and the Text of the Securities Exchange Act of 1934' (1998) 2 *Columbia Business Law Review* 359, 378.

<sup>108</sup> See page 23.

with a manipulative intention should always be sufficient for conduct, or a trade, to be characterised as manipulative.<sup>109</sup>

The ‘genuine supply and demand’ analysis indicates that a trader with a manipulative intention is non-genuine. A transaction involving them creates an artificial, or false or misleading, price. It seems that this reasoning would capture a trader whose intention was to create a false appearance of trading activity, even though this does not necessarily affect the market price and the analysis does not accurately explain why it is prohibited. As such, the ‘genuine supply and demand’ approach is too broad.

Finally, the regime is unnecessarily complex because trading with an intention to set or maintain the price of a security contravenes both sections. This creates uncertainty regarding how ASIC should frame enforcement actions and potentially enables defendants to resist prosecution with arguments based on textual differences between the provisions. This is further discussed in the next chapter.<sup>110</sup>

#### ***(d) Omission-Based Manipulation***

It is unclear in what circumstances an omission to act will contravene s 1041B(1). In particular, as Parliament has suggested that manipulative intention does not need to be proved,<sup>111</sup> it remains to be seen how the scope of civil penalty liability will be determined.

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<sup>109</sup> Ibid.

<sup>110</sup> See pages 49–50.

<sup>111</sup> Commentary on the Draft Provisions, Financial Services Reform Bill 2001 (Cth) (Treasury, February 2000) 11.10; *Australian Securities and Investments Commission v Sout* (2010) 183 FCR 21, 41 [80].

One possibility is to interpret the section as requiring that the accused had a duty to perform the act allegedly omitted, although the section does not indicate when such a duty arises. It might occur when the accused's conduct creates a situation in which a subsequent omission to disclose, or delay in disclosing, would mislead or deceive the market. For example, if a company disclosed details about a project, it might have a duty not to omit to disclose price-sensitive developments and any such omission might be considered manipulative. However, on this approach, the scope of liability is too broad. Whether the accused was under a duty would depend on an after-the-fact assessment, perhaps according to standards of reasonableness, and proof of manipulative intention is not required.

The better approach is to characterise an omission to act, or delay in acting, when motivated by a manipulative intention, as manipulation — irrespective of a duty to act or a demonstrated effect on the market. Such an omission is at least a *conspiracy* to manipulate the market, and might in some circumstances actually deceive investors about the true non-manipulated market price. On either explanation, the scope of liability under s 1041B(1) is too narrow, as proof of manipulative intention is not sufficient for contravention.<sup>112</sup>

***(e) Deeming Provision: s 1041B(2)***

A person who intentionally engages in a 'wash sale'<sup>113</sup> or 'matched order'<sup>114</sup> is 'taken to have created a false or misleading appearance of active trading' for the purposes of s 1041B(1).<sup>115</sup>

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<sup>112</sup> Admittedly this may be less problematic than initially appears. An omission perpetrated by a company director may be a breach of a continuous disclosure obligation or director's duty.

<sup>113</sup> Defined by *Corporations Act 2001* (Cth) s 1041B(2)(a). For an explanation of the section's operation, see *R v Manasseh* (2002) 167 FLR 44, 68 [71].

<sup>114</sup> Defined by *Corporations Act 2001* (Cth) s 1041B(2)(b).

<sup>115</sup> *Corporations Act 2001* (Cth) s 1041B(2).

The effect of this section is unclear, as the language is both textually and contextually ambiguous. While it clearly deems the physical element of s 1041B(1), it is uncertain whether it also deems the implied fault element required for criminal prosecution.<sup>116</sup>

If only the physical element is deemed, then the section is redundant. Courts already treat wash sales and matched orders as ordinarily creating a false or misleading appearance of active trading.<sup>117</sup>

If the fault element is deemed, then the section incorrectly treats a wash sale or matched order as conclusive proof of manipulation. At most, it is prima facie evidence of manipulative intention that can be rebutted by proof of a legitimate purpose.<sup>118</sup> Therefore, the scope of criminal liability is too broad. Furthermore, it is unclear whether the implied fault element for civil proceedings would be deemed. If not, this would perversely make criminal liability easier to establish than civil penalty contravention.

The previous *Corporations Act 1989* (Cth) regime provided a defence:<sup>119</sup> the defendant could adduce evidence inconsistent with having an intention to create a false or misleading

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<sup>116</sup> Emma Armson, 'False Trading and Market Rigging in Australia' (2009) 27 *Company and Securities Law Journal* 411, 416.

<sup>117</sup> *Braysich v The Queen* (2011) 243 CLR 434, 470 [97] (Bell J dissent, Heydon J agreeing); *Braysich v The Queen* (2009) 260 ALR 719, 726 [26], 739 [77]; *Endresz v Whitehouse* (1997) 24 ACSR 208, 226.

<sup>118</sup> *Braysich v The Queen* (2009) 260 ALR 719, 739 [77], 742 [93].

<sup>119</sup> *Corporations Act 1989* (Cth) s 998(6).

appearance of active trading.<sup>120</sup> This is preferable to the current regime, as it facilitates proof of intention without unduly broadening the scope of criminal liability.

### 3 *Critique of s 1041C*

Section 1041C(1) prohibits a person from (i) entering into, or engaging in, a *fictitious or artificial transaction or device* if that transaction or device (ii) *results in the price for trading in a financial product fluctuating*,<sup>121</sup> or being *maintained, inflated or depressed*.<sup>122</sup> These two physical elements are considered in turn.

#### *(a) Fictitious or Artificial Transaction or Device*

It is unclear what conduct is capable of contravening s 1041C(1). ‘Fictitious or artificial transaction or device’ is not defined in the Act and there is no authoritative case law.<sup>123</sup> It is unclear, for example, whether fictitious or artificial transaction is a composite concept or two different types of conduct.

A ‘fictitious transaction’, according to its ordinary meaning, is one that is counterfeit, false or not genuine.<sup>124</sup> It probably includes circumstances where a party intends that the transaction will not give effect to the legal rights and obligations it appears to create<sup>125</sup> — for example, a

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<sup>120</sup> *Braysich v The Queen* (2011) 243 CLR 434, 447 [22], 454 [36]–[37] (French CJ, Crennan and Kiefell JJ).

<sup>121</sup> *Corporations Act 2001* (Cth) s 1041C(1)(b).

<sup>122</sup> *Ibid* s 1041C(1)(a).

<sup>123</sup> For disagreement on the section’s legislative history and purpose, see obiter *DPP (Cth) v JM* (2012) 267 FLR 238, 279 [187]–[190], 290 [237], 291 [243] (Warren CJ), 316 [340]–[341] (Nettle and Hansen AJJ).

<sup>124</sup> Macquarie Dictionary.

<sup>125</sup> Goldwasser, *Stock Market Manipulation*, above n 8, 67.

wash sale, or an agreement to transfer a security on the condition that it is re-conveyed to the original owner and the second person does not have an obligation to pay for it.<sup>126</sup>

An ‘artificial transaction’, according to its ordinary meaning, is a transaction made by human skill and labour, as opposed to occurring naturally.<sup>127</sup> Section 1041C(2) provides that it is not conclusive that the transaction is, or was at any time, intended by the parties who entered into it to have effect according to its terms, indicating that it is not limited to sham transactions. One commentator has suggested that this is assessed objectively.<sup>128</sup> However, this cannot be the case. Trades executed through the market mechanism are objectively indistinguishable. Therefore, manipulative intention must be the defining feature of an artificial transaction.<sup>129</sup>

If any type of manipulative intention were sufficient, then artificial transaction would be transformed into a catchall for trade-based manipulation. This would deprive it of independent significance. The better possibility is that the parties must have intended to circumvent, or improperly exploit, the ordinary mechanics of the price formation process — for example, a matched order is brought about by collusion between buyer and seller, and ordinarily creates a false appearance of trading activity. On this interpretation, artificial transaction is merely a specific example of market activity manipulation.

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<sup>126</sup> Baxt, Black and Hanrahan, above n 8, 673.

<sup>127</sup> Macquarie Dictionary; *DPP (Cth) v JM* (2012) 267 FLR 238, 291 [243] (Warren CJ, obiter).

<sup>128</sup> Goldwasser, *Stock Market Manipulation*, above n 8, 67–68.

<sup>129</sup> See pages 20–22.

A ‘device’, according to its ordinary meaning, is a ‘plan or scheme for effecting a purpose’.<sup>130</sup> This suggests that device has both a physical and a fault component, neither of which Parliament has defined.

To the extent that Parliament has implied that proof of manipulative intention is not required for civil penalty contravention,<sup>131</sup> the scope of liability is too broad. This would unreasonably mean that any conduct, or trade, that has a price impact could be characterised as manipulative. This is too broad, as market prices ordinarily, and unobjectionably, respond to trading or conduct that conveys new information or changes investor expectations.<sup>132</sup> It would also be inconsistent with the requirement to prove manipulative intention under ss 1041A and 1041B(1).

If, as suggested, fictitious and artificial transactions can only be characterised by manipulative intention, then they are merely specific examples of trade-based manipulation targeting market activity. Likewise, device is simply a proxy for conduct-based manipulation. As such, s 1041C(1) completely overlaps with s 1041B(1) and is therefore redundant. It also creates unnecessary complexity, as it expresses the physical and fault elements for manipulation less clearly than does s 1041B(1). This obscures the nature and role of manipulative intention, making it difficult for ASIC to effectively frame prosecutions and

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<sup>130</sup> Macquarie Dictionary.

<sup>131</sup> Commentary on the Draft Provisions, Financial Services Reform Bill 2001 (Cth) (Treasury, February 2000) 11.10; *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 41 [80].

<sup>132</sup> Perdue, above n 8, 367–72.

allowing defendants to resist prosecution by making arguments about textual differences between the provisions.<sup>133</sup>

***(b) Actual Price Impact***

The requirement that the transaction or device actually *caused* the price of a financial product to fluctuate or be maintained, inflated or depressed<sup>134</sup> is conceptually unsound. As noted above, manipulative conduct and transactions are harmful independent of a demonstrated effect on market price or investor behaviour.<sup>135</sup> It follows that this requirement arbitrarily restricts the scope of liability. Furthermore, even if a demonstrable effect on the market were considered necessary, it does not follow that this should relate to price rather than market trading volumes.

Practically, for transactions, the requirement is either redundant or almost impossible to meet. If interpreted broadly, it is always satisfied by a transaction executed through the market mechanism. Every bid, offer and executed trade contributes information to the price formation process. Thus, every trade makes an incremental contribution, based on the price of execution and volume of securities traded, to a change in the market price.<sup>136</sup> If interpreted narrowly, the requirement means showing that a particular price change would not have occurred but for the transaction. This is nearly impossible to prove, as a myriad of factors could potentially contribute to a price change.<sup>137</sup> The difficulty is even greater for a device, because it must also be shown that the conduct contributed information to the price formation

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<sup>133</sup> See pages 49–50.

<sup>134</sup> *Corporations Act 2001* (Cth) s 1041C(1).

<sup>135</sup> See pages 22–23.

<sup>136</sup> Nelemans, above n 8, 12–15, 22–24.

<sup>137</sup> *Ibid* 22–25.

process or affected investor valuations of the security, and that this caused a particular price change.

#### **4 *Parliamentary Confusion about Manipulative Intention***

##### **(a) *Civil Penalty/Criminal Offence Distinction***

The distinction between the civil penalty and criminal offence regimes is that the former supposedly does not require proof of manipulative intention.<sup>138</sup> However, as manipulative intention is always necessary to characterise conduct or trading as manipulative,<sup>139</sup> no clear distinction can be made between the regimes.

##### **(b) *Complications of the Criminal Code Act***

Criminal prosecution requires proof of fault elements implied by the *Criminal Code Act 1995* (Cth).<sup>140</sup> For example, prosecution under s 1041A requires proof that the accused was *reckless* about whether their conduct caused, or was likely to cause, an artificial price.<sup>141</sup>

The application of the *Criminal Code Act 1995* (Cth)<sup>142</sup> is fundamentally unsound because it is predicated on a false assumption that there is a clear difference in the standard of manipulative intention required for civil penalties and criminal offences. Reliance on implied

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<sup>138</sup> Commentary on the Draft Provisions, Financial Services Reform Bill 2001 (Cth) (Treasury, February 2000) 11.10; *Australian Securities and Investments Commission v Sout* (2010) 183 FCR 21, 41 [80].

<sup>139</sup> See pages 20–23.

<sup>140</sup> *Criminal Code Act 1995* (Cth) sch 1 s 5.6; *Corporations Act 2001* (Cth) s 1308A.

<sup>141</sup> *Criminal Code Act 1995* (Cth) sch 1 s 5.6(2).

<sup>142</sup> *Ibid* sch 1 s 5.6.

generic fault elements is also inappropriate, given the central role and specific content of manipulative intention.

It makes no sense to require proof that the accused was *reckless* towards creating an artificial price. A person cannot be *reckless* towards a result where the characterisation of that result depends on a determination that the person acted with a manipulative *intention*. Phrased differently, the requirement is circular because it depends on a prior identification of manipulative intention. The implied fault element is also redundant because proof of *intention* should be sufficient for conduct to be manipulative, and proof of *intention* is by definition sufficient to establish *recklessness*.<sup>143</sup>

Furthermore, *recklessness* is not a sufficiently strict fault requirement for conduct to be manipulative. It is inconsistent with the requirement of manipulative intent. Investors are often reckless about whether their trades will have a price impact: this is an unobjectionable feature of speculation.<sup>144</sup> In contrast, manipulative *intention* is a fundamentally different state of mind. It goes beyond executing a trade that is not justified by the trader's private information and introduces into the market information that they *subjectively know to be false*.

### ***C Implications***

This chapter has highlighted several deficiencies with the current regulatory regime. These stem from Parliament's failure to clearly articulate the nature and role of manipulative intention. Thus, the scope of liability is, on the one hand, too broad, as manipulative intention

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<sup>143</sup> Ibid sch 1 s 5.4(4).

<sup>144</sup> Loke, above n 77, 46.

is not necessary for contravention. On the other hand, it is too narrow, as engaging in conduct with a manipulative intention is not sufficient for contravention.

Artificial price, fictitious and artificial transaction, and device are proxies for trade-based and conduct-based manipulation. They should be replaced with a prohibition that explicitly states the requisite manipulative intention. Additionally, ss 1041B(2) and 1041C(1) suffer from textually and contextually ambiguous language, rendering their scope and the requirements for contravention uncertain. The regime is unnecessarily complicated, as all sections significantly overlap.

Finally, the fault elements implied by the *Criminal Code Act 1995* (Cth) are inconsistent with the requirement of manipulative intention and are predicated on an untenable distinction between the civil penalty and criminal offence regimes. Having both regimes is unnecessary. A simple, clear and consistent treatment of manipulation is warranted.

These defects show that substantive law reform is required to achieve a conceptually sound regime with an appropriate scope of liability. The reforms will be most effective if accompanied by a clear statement of the policy objectives for prohibiting manipulation. The changes must be effectively communicated to the investing public in order to reposition manipulation as a serious criminal offence.

The reforms will play an important role in effectively deterring manipulation, maintaining public confidence in financial market integrity, and maximising the economic benefits of financial markets. The next chapter turns to the issue of substantive law reform.

## CHAPTER 2: SUBSTANTIVE LAW REFORM PROPOSALS

The current regime inadequately protects Australian financial markets and investors from manipulation. A substantial rethink of the regulatory approach is needed, in terms of the substantive prohibitions and their positioning in the wider regulatory framework for financial markets. In particular, a broad and flexible prohibition should replace the current overly complex and technical regime. This prohibition should be enacted in a *Serious Financial Market Crimes Act 2014* (Cth), which will publicly reposition manipulation as a criminal offence. This chapter describes these proposals and discusses their benefits in detail.

### A *Anti-Manipulation Regime*

The proposed anti-manipulation regime will be part of a *Serious Financial Market Crimes Act 2014* (Cth), as described below. The Act has several components that are beyond the scope of this thesis, including definitions, jurisdiction, penalties and other offences. Where possible, the Act will use definitions and terminology from the *Corporations Act 2001* (Cth), including definitions of ‘financial product’<sup>145</sup> and ‘financial market’.<sup>146</sup> This allows the provisions to be interpreted in light of the existing *Corporations Act* case law, thereby promoting certainty and consistency for market participants.

The *Criminal Code Act 1995* (Cth) also continues to apply. This provides for a consistent interpretation of fault elements, in line with other Commonwealth offences. Additionally, the

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<sup>145</sup> *Corporations Act 2001* (Cth) ss 763A–763E, 764A, 765A.

<sup>146</sup> *Ibid* s 767A.

*Criminal Code Act 1995* (Cth) will provide for ancillary liability.<sup>147</sup> However, it will not imply generic fault elements, as the proposals specify the requisite manipulative intention.<sup>148</sup>

As a final introductory point, the Act should contain a provision equivalent to s 1041D. This makes it an offence to spread information about the occurrence of a manipulation where the person or their associate has committed the manipulation or would benefit, or avoid a detriment, from spreading the information. This will limit the harm caused by manipulation. Further consideration of this section is beyond the scope of this thesis.

## **1 *Proposed Provisions***

The proposed regime consists of four provisions and a note. The first two provisions are criminal prohibitions on manipulation. The third and fourth provisions set out circumstances in which a person is conclusively deemed to have acted with the requisite manipulative intention.

It must be emphasised that the precise wording of the provisions is ultimately subject to expert parliamentary drafting and feedback on an exposure draft following public consultation. Therefore, this thesis advocates for the broad and flexible approach embodied in the proposal, rather than arguing for precise wording. The provisions are as follows:

- (1) A person must not enter into, or engage in (whether directly or indirectly), a transaction if their dominant purpose for entering into, or engaging in, the transaction is to manipulate the market for, or the price of, a financial product.

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<sup>147</sup> *Criminal Code Act 1995* (Cth) sch 1 pt 2.4 div 11.

<sup>148</sup> *Ibid* sch 1 s 5.6.

- (2) A person must not do, or omit to do, an act if their dominant purpose for doing, or omitting to do, the act is to manipulate the market for, or the price of, a financial product.
- (3) A person is conclusively deemed to have had the dominant purpose of manipulating the price of a financial product if the person intended to set or maintain the price of the financial product at a particular level, or the person intended to cause an unjustified change in the price of the financial product.
- (4) A person is conclusively deemed to have had the dominant purpose of manipulating the market for a financial product if the person intended to create a false or misleading appearance of genuine trading activity.

Note 1: Contravention of (1) or (2) is a criminal offence.

To contravene the proposed prohibitions, it must be shown that (i) the accused did an act, omission or transaction; (ii) the accused intended to do that act, omission or transaction; and (iii) the act, omission or transaction was done for the dominant purpose of manipulating the market for, or price of, a financial product.<sup>149</sup> The standard of proof is beyond reasonable doubt.<sup>150</sup> The offence's structure embodies the core features of manipulation discussed at the start of this thesis.<sup>151</sup> In particular, proof of the requisite manipulative intention is the crucial element in establishing a contravention.

The proposed prohibitions are identical, except that the first prohibits transactions and the second prohibits acts or omissions (excluding transactions). This distinction, based on the type of manipulative conduct, will facilitate the development of nuanced case law regarding the method of proving manipulative intention. In particular, appropriate legal tests for

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<sup>149</sup> See Appendix 2 for comparison of the physical and fault elements of the current and proposed regimes.

<sup>150</sup> *Criminal Code Act 1995* (Cth) sch 1 s 13.2(1).

<sup>151</sup> See pages 11–16.

inferring intention from circumstantial evidence will develop based on the different manipulative techniques that come before the courts and the manner in which ASIC frames enforcement actions. This is clearer than s 1041B(1), which does not distinguish between acts, transactions and statements. It also means that courts have sufficient flexibility to develop case law that captures novel manipulative techniques.

The prosecutor has the legal burden of proving that the accused had the dominant purpose of manipulating the market for, or price of, a financial product.<sup>152</sup> This may be proved directly or by relying on the deeming provisions, as discussed below. At a minimum, a dominant purpose is a *but for* purpose, meaning that the conduct would not have occurred absent the purpose. If the conduct could possibly have been motivated by more than one purpose, the prosecutor must prove that the manipulative purpose was the most significant or overriding purpose. It is not sufficient to merely prove that it was *a motivation*.<sup>153</sup> It is not necessary to prove that it was the sole motivating purpose.

If it is proved that the accused had a manipulative intention, it ordinarily follows that this was their dominant purpose. This is because having a manipulative intention is ordinarily incompatible with having a legitimate commercial motivation. Difficult questions of fact arise if multiple purposes, some of which are legitimate, could possibly have motivated the conduct.<sup>154</sup> For example, the accused might assert that a wash sale was done for the legitimate purpose of transferring a security between investment accounts in a single beneficial investment fund. The court must ultimately resolve this question of fact based on

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<sup>152</sup> *Criminal Code Act 1995* (Cth) sch 1 s 13.1(1).

<sup>153</sup> Rostow, above n 32, 636–37.

<sup>154</sup> Fischel and Ross, above n 8, 519.

common sense, having regard to all relevant circumstances. Courts are well placed to do this, as they have experience dealing with sole or dominant purpose standards in the context of directors' duties<sup>155</sup> and legal professional privilege.<sup>156</sup>

It must also be emphasised that, contrary to the suggestion of some commentators,<sup>157</sup> the accused does not, and should not, have a legal burden of proving that they had a legitimate purpose. This would arguably be inconsistent with community expectations about fair criminal trial procedures and would undermine the presumption of innocence.<sup>158</sup> That said, if the accused does not adduce evidence consistent with a legitimate purpose, the court is unlikely to give that explanation much weight and the prosecution will not have to adduce very strong evidence to disprove it.<sup>159</sup>

The proposed prohibitions capture manipulation targeting the 'market price' and the 'market'. This reflects the two categories of manipulation discussed earlier.<sup>160</sup> Two deeming provisions provide that proof of a proscribed mental state is sufficient to conclusively deem that the accused had the dominant purpose of manipulating the market for, or price of, a financial product. Once the prosecution proves the proscribed mental state, the accused

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<sup>155</sup> *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 294.

<sup>156</sup> *Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1999) 201 CLR 49, 64 [35], 72 [57]–[60].

<sup>157</sup> Rostow, above n 32, 636; Roman Tomasic, 'Insider Trading Law Reform in Australia' (1991) 9 *Company and Securities Law Journal* 121, 132; Goldwasser, *Stock Market Manipulation*, above n 8, 84; Donald, above n 8, 80–82.

<sup>158</sup> *Contra* Tomasic, above n 157, 132.

<sup>159</sup> Donald, above n 8, 81.

<sup>160</sup> See pages 11–16.

cannot ‘go behind’ the deeming provision by arguing that the mental state does not amount to a manipulative intention.<sup>161</sup>

The first deeming provision relates to market price manipulation. It provides that if the accused intended to set or maintain the market price at a particular level, or to cause an unjustified change in the market price, they are conclusively deemed to have had a dominant purpose to manipulate the market price. This captures persons who intend to set or control the market price, but not those whose trades impact, but submit to, the market price.<sup>162</sup> It is not manipulative to value a security differently from other investors, buy securities at a premium, or sell securities at a discount.

The second deeming provision relates to market activity manipulation. It provides that if the accused intended to create a false or misleading appearance of genuine trading activity, they are conclusively deemed to have had a dominant purpose to manipulate the market. This reflects the current case law on market activity manipulation. It captures a person whose conduct, or trading, is designed to mislead investors into falsely believing that there is genuine trading activity.<sup>163</sup>

The deeming provisions are not exhaustive. The prosecutor can also allege that other mental states are sufficient to prove a dominant purpose to manipulate the market for, or price of, a financial product. For example, it is open to courts to hold — as with the United States

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<sup>161</sup> See the explanation in *Braysich v The Queen* (2009) 260 ALR 719, 733 [52]–[55].

<sup>162</sup> *North v Marra Developments Ltd* (1981) 148 CLR 42, 59.

<sup>163</sup> *Braysich v The Queen* (2011) 243 CLR 434, 470 [97] (Bell J dissent, Heydon J agreeing); *Braysich v The Queen* (2009) 260 ALR 719, 726 [26], 739 [77].

requirement for private enforcement actions under Rule 10-b<sup>164</sup> — that proof of an intention to ‘deceive, manipulate or defraud’<sup>165</sup> is sufficient to establish a dominant purpose to manipulate the market. In this respect, the deeming provisions would indicate Parliament’s intention that the provisions be interpreted broadly and in response to changing market structures, technology and manipulative techniques. This is a significant benefit, given that manipulation is difficult to define but manipulative techniques are often identifiable.<sup>166</sup>

## ***2 Benefits and Potential Criticisms of the Proposal***

The preceding discussion has shown that the proposed prohibitions are simpler and clearer than the current regime. It will be shown that they are conceptually sound and easier to enforce, and will reposition manipulation as a serious criminal offence. These significant benefits outweigh the inevitable short-term uncertainty and the compliance and dissemination costs of a substantive change to the law.<sup>167</sup>

### ***(a) Conceptual Soundness***

The proposed prohibitions have an appropriate scope of liability. They are predicated on a conceptually sound understanding of manipulation that clearly defines the role of manipulative intention — that is, proof that the accused acted with the proscribed

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<sup>164</sup> There is an implied right of private action under Rule 10-b, enacted pursuant to § 10(b) of the *Securities Exchange Act of 1934*: *Superintendent of Insurance of New York Bankers Life & Casualty Co* 404 US 6 (1971); *Blue Chip Stamps v Manor Drug Stores* 421 US 723 (1975); Goldwasser, *Stock Market Manipulation*, above n 8, 92.

<sup>165</sup> *Ernst & Ernst v Hochfelder* 425 US 185, 199 (1976); *Santa Fe Industries, Inc v Green* 430 US 462, 476 (1977); *Schreiber v Burlington Northern, Inc* 105 S Ct 2458 (1985); *United States v Mulheren* 938 F 2d 364 (2d Cir 1991).

<sup>166</sup> Goldwasser, *Stock Market Manipulation*, above n 8, 154.

<sup>167</sup> Jeffrey Lawrence, ‘The Economics of Market Confidence: (Ac)Costing Securities Market Regulations’ (2000) 18 *Company and Securities Law Journal* 171, 177, 180–83.

manipulative intention is both necessary and sufficient for a transaction, act or omission to contravene the prohibitions.

First, it is necessary to prove that the accused had the proscribed manipulative intention. This requirement ensures that only persons with a culpable state of mind can be held to have manipulated the market. Unlike the current regime, it correctly recognises that a bid, offer or executed trade cannot be characterised as manipulative absent proof of manipulative intention.<sup>168</sup> A related point is that the regime clearly defines the requisite *intention*. Unlike the implied fault elements under the current regime, it is not sufficient that the accused was merely *reckless* about whether their conduct would have a price impact. The proposed regime thus ensures that a person cannot be wrongly held to have manipulated the market merely because they used an innovative trading strategy, or their conduct had an unusual effect on the market that is inexplicable based on historical price trends or price relationships with other assets.<sup>169</sup> At most, these are circumstantial factors relevant to inferring intention.

By insisting on proof of manipulative intention, the proposed regime strikes an appropriate balance between protecting investors from intentional abuse and facilitating the dynamic operation of market forces. The provisions provide sufficient certainty for market participants to confidently self-regulate their behaviour and exercise the necessary business judgments required to comply with the prohibitions.<sup>170</sup> Market participants can form different valuations of a security, engage in price-impacting speculation, and adopt innovative trading techniques, provided they do not do so for the dominant purpose of manipulating the market for, or price

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<sup>168</sup> See pages 20–22.

<sup>169</sup> Kozinn, above n 67, 261–62.

<sup>170</sup> Geoffrey Hart, ‘The Regulation of Stock Market Manipulation’ (1979) 7 *Australian Business Law Review* 139, 151.

of, a financial product. Therefore, the regime does not impede legitimate financial market innovation.

A potential criticism of the proposed regime is that it will deter legitimate and socially beneficial trading activity.<sup>171</sup> In particular, it might be claimed that investors will refrain from executing price-impacting trades or using innovative trading strategies to avoid manipulative intention being wrongly imputed.<sup>172</sup>

The risk of such imputation is so negligible that it is not a compelling criticism of the proposed provisions. The simple fact that conduct has an unusual effect on the market is never, in itself, sufficient to infer manipulative intention.<sup>173</sup> Also, an innocent person is well placed to adduce evidence of the legitimate commercial motivation for their conduct, thereby creating reasonable doubt about manipulative intention.<sup>174</sup> In relative terms, this risk is significantly lower than under the current regime, which does not require proof of manipulative intention if the proscribed effect is observed on the market.

In practice, the risk is unlikely to materialise. ASIC's limited enforcement budget, which has been reduced in recent years,<sup>175</sup> precludes it from investigating borderline cases. More significantly, ASIC and the Director of Public Prosecution have high standards of

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<sup>171</sup> Fischel and Ross, above n 8, 522; Nelemans, above n 8, 21; Huang, above n 8, 17–18.

<sup>172</sup> Avgouleas, above n 8, 112.

<sup>173</sup> Kozinn, above n 67, 261–62; Perdue, above n 8, 367–72.

<sup>174</sup> Donald, above n 8, 81.

<sup>175</sup> Nassim Khadem and Georgia Wilkins, 'Budget Alters ASIC Proactive Surveillance', *The Australian Financial Review*, 31 May 2014; Patrick Durkin, 'Agencies Slashed and Abolished', *The Australian Financial Review*, 14 May 2014.

investigatory and prosecutorial integrity.<sup>176</sup> Cases lacking a high degree of certainty with regard to manipulative intention will likely be filtered out.

The second aspect that provides conceptual soundness is that the proposed provision's scope of liability is broader than in the current regime. Engaging in conduct, or trading, with the proscribed manipulative intention is sufficient to contravene the prohibitions. Thus, unlike the current regime, it is not necessary to prove that the conduct had, or was likely to have, a demonstrable effect on the market or the behaviour of investors.

As discussed earlier, this is appropriate because engaging in manipulative conduct, or trading, is immediately harmful. It either introduces *subjectively* false information into the price formation process, or is a conspiracy to manipulate the market.<sup>177</sup> A person engaging in such conduct has done everything within their control to manipulate the market. As such, proof of a demonstrable effect is not necessary, or an appropriate basis, for liability.<sup>178</sup> This requirement would also arbitrarily limit the scope of liability, as any such effect depends largely on factors beyond the manipulator's control, such as the size and liquidity of the market.<sup>179</sup> It also means that the provisions ensure that large and highly liquid markets — which are difficult to manipulate by way of price impact<sup>180</sup> — are adequately protected from the same kinds of manipulative conduct as are less liquid markets.

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<sup>176</sup> ASIC, 'ASIC's Approach to Enforcement' (Information Sheet, Number 151, September 2013); Commonwealth Director of Public Prosecutions, 'Prosecution Policy of the Commonwealth' (Policy, 4 March 2009).

<sup>177</sup> See pages 22–23.

<sup>178</sup> *Ibid.*

<sup>179</sup> Donald, above n 8, 77–78.

<sup>180</sup> *Ibid.*

Abandoning the requirement of a demonstrable effect makes the proposals conceptually more sound and easier to enforce than the current regime. The highly problematic case law, which tried to explain why trading with a manipulative intention was *likely* to have a demonstrable effect on the market,<sup>181</sup> is no longer necessary. More significantly, since liability depends on the trader's intention rather than an arbitrary or unquantifiable effect on the market, the provisions capture a wide range of manipulative schemes. The broad drafting of the provisions is expected to encompass novel techniques that are likely to develop in the future.

***(b) Enforceability***

The proposed provisions clearly define the elements that must be proved at trial, including the nature and role of manipulative intention. This makes it easier for ASIC or the Director of Public Prosecutions to frame enforcement actions in terms of the required physical and fault elements and is likely to improve ASIC's success rates at trial. This is illustrated by contrasting the process of prosecuting an offender under each regime. Consider the typical example of a person who executes a trade with the intention to set or maintain the price of a security.<sup>182</sup>

Under the proposed regime, the prosecutor must establish that the accused intentionally traded for the purpose of setting the market price of the security at a particular level. If this is shown, the accused is conclusively deemed to have acted with the dominant purpose of manipulating the price of the security and so contravenes the provision. In contrast, under the current regime, the prosecutor must prove several additional steps, including the construction of artificial price; that the conduct was *likely* to create an artificial price; and, for criminal

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<sup>181</sup> See pages 23–28.

<sup>182</sup> Black, 'Insider Trading and Market Misconduct', above n 99, 322.

prosecution, that the accused was *reckless* about whether their conduct would create an artificial price.

These additional steps do not contribute to the analysis of whether the accused's conduct is manipulative. However, they raise the possibility of legalistic defence arguments to resist prosecution — for example, the construction of artificial price, the inconsistencies between the civil penalty and criminal offence fault requirements, and the inconsistent physical and fault elements between overlapping provisions.<sup>183</sup> These arguments do not bear on the accused's culpability, as they do not relate to manipulative intention. However, they may allow the accused to escape liability.

The proposed prohibitions are framed with a clearly defined manipulative intention requirement. This allows ASIC to present its case directly in terms of the requisite intention, without needing to treat it as one step in proving an objective effect on the market. Courts can confidently engage with the evidence and, if appropriate, make an inference of manipulative intention. This significantly improves on the current regime, in which the nature and role of intention are obscured by the concepts of artificial price, artificial transaction, fictitious transaction and device.<sup>184</sup> These concepts may confuse the issues and distract the court, making it difficult to correctly assess whether the accused had the proscribed intention.

The proposed regime also enables ASIC to more effectively allocate its limited enforcement resources. Increased certainty about the elements that must be proved at trial allows ASIC to selectively investigate and prosecute matters that have the best chance of obtaining a

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<sup>183</sup> Similar arguments were made by the respondent in *DPP (Cth) v JM* (2013) 87 ALJR 83: JM, 'Respondent's Submissions on Appeal', Submission in *DPP (Cth) v JM*, 15 February 2013.

<sup>184</sup> See pages 18–34.

conviction.<sup>185</sup> This is an important consideration in light of recent, and continuing, reductions in ASIC's enforcement budget.<sup>186</sup> At present, ASIC's ability to successfully prosecute offenders is hamstrung by uncertainty about the construction of the current regime and the ambiguity of manipulative intention. This may deter ASIC from prosecuting cases that do not clearly fall within the core of the prohibition. The proposed prohibitions will directly enhance ASIC's ability to successfully bring enforcement actions. This will boost the general deterrence effect of the prohibitions, thereby contributing to public confidence in financial market integrity.<sup>187</sup>

Critics might claim that the proposed provisions will be ineffective, as it will be extremely difficult to prove manipulative intention and thus successfully prosecute offenders.<sup>188</sup> They could provide several arguments for this. First, there is unlikely to be direct evidence of the offender's state of mind, and circumstantial evidence is often insufficient to infer manipulative intention. Second, most of the evidence — particularly trading data — is equivocal, meaning that it is equally consistent with legitimate or illegitimate conduct.<sup>189</sup> Third, defendants can sometimes create reasonable doubt about whether they had a manipulative intention by concocting an after-the-fact rationalisation for their conduct.<sup>190</sup>

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<sup>185</sup> Gill North, 'The Australian Insider Trading Regime: Workable or Hopelessly Complex?' (2009) 27 *Company and Securities Law Journal* 310, 318.

<sup>186</sup> Khadem and Wilkins, above n 175; Durkin, 'Agencies Slashed and Abolished', above n 175.

<sup>187</sup> Gibson, above n 17, 8.

<sup>188</sup> TheI, '\$850,000 in Six Minutes', above n 6, 247.

<sup>189</sup> Goldwasser, *Stock Market Manipulation*, above n 8, 113; Black, 'Insider Trading and Market Misconduct', above n 99, 314.

<sup>190</sup> Michael J Duffy, 'Insider Trading: Addressing the Continuing Problems of Proof' (2009) 23 *Australian Journal of Corporate Law* 149, 158; Rostow, above n 32, 635.

While these criticisms have some force, they should not be overstated and they do not significantly undermine the effectiveness of the proposed regime. An initial response is that these difficulties are less acute for the proposed regime than under the current regime. In the proposed regime, the requisite manipulative intention is clearly articulated and closely related to whether the manipulator targets the market or the market price. In contrast, the difficulties of proving manipulative intention in the current regime are compounded by uncertainty about its precise nature and role and the failure to clearly differentiate the two categories of manipulation. Furthermore, the manipulative intention requirements set out by the deeming provisions are preferable to the specific intent requirements adopted in other jurisdictions. For example, a requirement of intention to induce other traders to buy or sell securities at the manipulated price<sup>191</sup> or intention to ‘deceive, manipulate or defraud’<sup>192</sup> is significantly more difficult to prove because it is highly specific.

A more substantial response is that the difficulties of proving manipulative intention are overstated. Courts can — and do — infer manipulative intention from direct evidence of the manipulator’s state of mind or from a mosaic of circumstantial factors.<sup>193</sup> As more cases are litigated in the future, the courts’ understanding of manipulation will increase, as will their ability to draw an inference of manipulative intention.

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<sup>191</sup> *Corporations Act 1989* (Cth) s 997; *Securities Industry Act 1980* (Cth) s 123; *Securities Industry Act 1975* (NSW) s 71.

<sup>192</sup> Goldwasser, *Stock Market Manipulation*, above n 8, 92; *Ernst & Ernst v Hochfelder* 425 US 185, 199 (1976); *Santa Fe Industries, Inc v Green* 430 US 462, 476 (1977); *Schreiber v Burlington Northern, Inc* 105 S Ct 2458 (1985).

<sup>193</sup> Huang, above n 8, 12–13; Latimer, above n 12, 250.

In some cases, there is direct evidence — such as emails or transcripts of intercepted telephone calls — of the manipulator’s state of mind.<sup>194</sup> This is generally a compelling, and possibly determinative, basis from which a court will infer manipulative intention.<sup>195</sup>

Furthermore, ASIC is likely to have greater access to direct evidence in the future, as it refines its use of evidence-gathering and telephone interception powers conferred in 2010.<sup>196</sup>

More commonly, courts must infer manipulative intention from circumstantial evidence.

Courts have a reasonably good understanding of certain indicative factors and can draw such inferences when appropriate. These factors include, for example, placing a large number of orders at the close of trading,<sup>197</sup> using multiple brokers,<sup>198</sup> slicing orders into small quantities at the same price and sending them to the market at once,<sup>199</sup> not seeking to buy as cheaply or sell as highly as possible,<sup>200</sup> the presence of a collateral profit motive such as a contract or highly leveraged futures position,<sup>201</sup> and acquiring a large position to allow monopoly

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<sup>194</sup> For example, *Donald v Australian Securities and Investments Commission* (2000) 104 FCR 126, 134 [22]; *Australian Securities Commission v Nomura International Plc* (1998) 89 FCR 301.

<sup>195</sup> *Donald v Australian Securities and Investments Commission* (2000) 104 FCR 126, 134 [22]; *Australian Securities Commission v Nomura International Plc* (1998) 89 FCR 301.

<sup>196</sup> *Corporations Amendment (No 1) Act 2010* (Cth) sch 1 ss 21–22.

<sup>197</sup> *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 35 [56]; Hart, above n 170, 143; Thel, above n 107, 378.

<sup>198</sup> Hart, above n 170, 143.

<sup>199</sup> Johanna Uy, ‘Direct Market Access Trading and Implications for Australian Securities Regulation’ (2006) 24 *Company and Securities Law Journal* 422, 427–28.

<sup>200</sup> Perdue, above n 8, 396.

<sup>201</sup> Shaun D Ledgerwood and Paul R Carpenter, ‘A Framework for the Analysis of Market Manipulation’ (Research Report, The Brattle Group, 5 June 2012) 17, 35 <<http://ssrn.com/abstract=1811764>>.

power.<sup>202</sup> It is also relevant whether the conduct causes an unusual effect on the market price or trading volumes that is inexplicable based on historical price trends or new information.<sup>203</sup>

More importantly, courts can readily identify many common and well-understood market activity manipulation techniques, such as churning, wash sales, matched orders, pools and sham transactions.<sup>204</sup> If these are observed, courts will ordinarily infer that the accused acted with the manipulative intention of creating a false or misleading appearance of active trading,<sup>205</sup> as this is the ordinary consequence of such conduct. Similarly, most reported manipulation cases involve relatively straightforward trade-based manipulation targeting the market price, such as ramping and marking the close.<sup>206</sup> These clearly fall within the scope of the proposed deeming provisions. Thus, the proposed regime effectively facilitates prosecution of the most common types of manipulation.

Finally, it is acknowledged that the proposed prohibitions do not solve all difficulties of proving manipulative intention. However, this is not their purpose and it is not a persuasive argument against adopting them. Practical reform of ASIC's evidence-gathering powers, or of trial and evidential procedures, could augment the proposed provisions. While close consideration of these practical measures is beyond the scope of this thesis, some examples are noted. These include bounties and rewards for tip-offs,<sup>207</sup> a formal leniency and immunity

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<sup>202</sup> Black, 'Regulating Market Manipulation', above n 27, 995.

<sup>203</sup> Kozinn, above n 67, 261–62; Perdue, above n 8, 367–72.

<sup>204</sup> Redmond, above n 26, 922–23.

<sup>205</sup> Rostow, above n 32, 636.

<sup>206</sup> Black, 'Insider Trading and Market Misconduct', above n 99, 322.

<sup>207</sup> D'Aloisio, 'Insider Trading', above n 4, 14; Tomasic, above n 157, 124–25; Duffy, above n 190, 159–61.

policy for people who report manipulation,<sup>208</sup> and designating ASIC as a telecommunications interception agency or an authorised recipient so that it can directly receive telephone interception warrants or use evidence from telephone intercepts.<sup>209</sup> If reforms in these areas improve the chances of obtaining direct evidence of manipulative intention, or increase the range of circumstantial evidence available, or facilitate proof of intention at trial, they will contribute to the effectiveness of the proposed regime.

### ***(c) Criminal Offence***

As stated above, the proposed prohibitions are criminal offences only. The decision not to retain civil penalties is likely to be controversial and requires justification. It is argued that manipulation is best understood exclusively as a criminal offence. This aligns with its strategic role in deterring manipulation.

The current regime classifies manipulation as both a criminal and civil penalty offence, implying that sometimes it is only a technical or administrative offence. This fails to reflect the offender's wrongful state of mind, as evidenced by the important role of manipulative intention. Arguably, it is also out of line with community perceptions that manipulation is a serious crime and that civil penalty proceedings are often inadequate.<sup>210</sup>

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<sup>208</sup> D'Aloisio, 'Insider Trading', above n 4, 14; Duffy, above n 190, 167.

<sup>209</sup> Tom Middleton, 'ASIC's Regulatory Powers — Interception and Search Warrants, Credit and Financial Services Licences and Banning Orders, Financial Advisers and Superannuation: Problems and Suggested Reforms' (2013) 31 *Company and Securities Law Journal* 208, 212–14; Janet Austin, 'A Rapid Response to Questionable Trading: Moving towards Better Enforcement of Australia's Securities Laws' (2009) 27 *Company and Securities Law Journal* 203, 208.

<sup>210</sup> See, eg, Nassim Khadem, Marianna Papadakis and Glenda Kwek, 'Penalties Must Be Tougher, Say Lawyers', *The Australian Financial Review*, 25 March 2014; Patrick Durkin, 'Judge Says ASIC Too Light on Offenders', *The Australian Financial Review*, 22 October 2013; Michael Mills and

The current regime does not successfully distinguish the fault requirements for criminal offences and civil penalty contravention.<sup>211</sup> No clear distinction can be made, as manipulative intention is the defining feature of manipulation. If, for example, criminal liability depended on dishonesty, or on investors being deceived, this would be an arbitrary requirement and not necessarily related to the harm caused by manipulation. Furthermore, any attempt to define criminal liability based on the size of the harm caused or the amount of profit the manipulator receives is also arbitrary.<sup>212</sup> Additionally, it fails to adequately distinguish between manipulators based on their culpability. Manipulators are not solely responsible for the amount of harm caused or profit gained. This depends, at least in part, on factors beyond their control.

Manipulation is appropriately classified as a criminal offence. It has been described as dishonest,<sup>213</sup> fraudulent,<sup>214</sup> vile and dishonourable,<sup>215</sup> cheating<sup>216</sup> and insidious.<sup>217</sup> Such characterisations recognise that manipulation is immoral conduct that falls short of accepted business standards and generally involves an attempt to obtain a benefit, or avoid a loss, in an

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Grant Marjoribanks, 'ASIC Fires Warning Shots over Corporate Australia', *The Australian Financial Review*, 10 February 2012; *Scook v The Queen* (2008) 185 A Crim R 16 at [50].

<sup>211</sup> See pages 35–36.

<sup>212</sup> For this approach, see Vivien R Goldwasser, 'The Regulation of Stock Market Manipulation: A Blue-Print for Reform' (1998) 9 *Australian Journal of Corporate Law* 109, 112.

<sup>213</sup> *Braysich v The Queen* (2011) 243 CLR 434, 456 [44] (French CJ, Crennan and Kiefell JJ).

<sup>214</sup> *R v De Berenger* (1814) 105 Eng Rep 534, 583 (Ellenborough CJ); *Scott v Brown, Doering, McNab & Co* [1892] 2 QB 724, 733 (Smith LJ).

<sup>215</sup> *Rubery v Grant* [1872] 13 LR 443, 447–448.

<sup>216</sup> Loke, above n 77, 37.

<sup>217</sup> Norman S Poser, 'Stock Market Manipulation and Corporate Control Transactions' (1986) 40 *University of Miami Law Review* 671, 735.

illegitimate manner and at the expense of other investors,<sup>218</sup> which is reflected in the need to prove manipulative intention. Manipulation also has the potential to undermine the integrity of the market price, thereby causing pervasive economic harm.<sup>219</sup> As such, it warrants the moral stigma and serious penalties that arise from being a criminal offence.

From a practical perspective, classifying manipulation as a criminal offence is consistent with the proper role of the anti-manipulation prohibition. The prohibition is a ‘backstop’, designed to enable strategic and targeted prosecutions of high-profile, egregious or blatant manipulators.<sup>220</sup> Such prosecutions are intended to have a general deterrent effect.<sup>221</sup> Courts explicitly recognise this and regard general deterrence as an important factor in sentencing convicted manipulators.<sup>222</sup> This greatly raises the stakes for people considering engaging in manipulation. Instead of facing a monetary penalty, they risk imprisonment and the moral stigma of criminal conviction. Educated professionals in the financial services industry are likely to consider these penalties as being particularly significant.<sup>223</sup> As these persons often

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<sup>218</sup> Goldwasser, ‘Regulating Manipulation in Securities Markets’, above n 35, 172; Paul Barnes, ‘Insider Dealing and Market Abuse: The UK’s Record on Enforcement’ (2011) 39 *International Journal of Law, Crime and Justice* 174, 175.

<sup>219</sup> D’Aloisio, ‘Insider Trading’, above n 4, 3–4.

<sup>220</sup> Rowan Bosworth-Davies, ‘The Regulator’s Tale: A Triumph of Hope over Experience!’ (2013) 34 *Company Lawyer* 33, 33–34; Söderström, above n 16, 34.

<sup>221</sup> ASIC Chairman Tony D’Aloisio, ‘ASIC’s Approach to Market Integrity’ (Speech delivered at the Monash Centre for Regulatory Studies and Clayton Utz Luncheon Lecture, Melbourne, 11 March 2010) 10–12; Tregillis, above n 38, 11–12; John C Coffee Jr, ‘Law and the Market: The Impact of Enforcement’ (2007) 156 *University of Pennsylvania Law Review* 229, 310–11; D’Aloisio, ‘Insider Trading’, above n 4, 8, 10.

<sup>222</sup> *Musumeci v Australian Securities and Investments Commission* (2009) 109 ALD 677, 685 [55]; *Australian Securities and Investments Commission v Soust (No 2)* (2010) 78 SASR 1 at [31]–[33]; *Brown v The Queen* (2006) 202 FLR 98, 99 [2], 104 [26]–[28]; *Scook v The Queen* (2008) 185 A Crim R 16 at [54]; *R v Chan* (2010) 79 ACSR 189, 194 [22]; *R v Pantano* (1990) 49 A Crim R 328, 330; *R v Rivkin* (2003) 198 ALR 400, 409 [44].

<sup>223</sup> Justice Ray Finkelstein, ‘Crimes and Punishments of Competition Law’ (2011) 18 *Competition and Consumer Law Journal* 207, 210–11; Barnes, above n 218, 187; Vicky Comino, ‘The Challenge

have the knowledge and opportunity to engage in manipulation, they are an important focus for general deterrence.

The proposed regime also recognises that manipulation is a difficult crime to prosecute. It requires extensive evidence gathering and the presentation of complex factual issues at trial. The cost, expense, time and expertise required to successfully prosecute manipulation preclude it from being enforced in a fast and routine manner and reinforce its criminal nature.<sup>224</sup> This probably explains why there has not been a dramatic increase in enforcement actions since the introduction of the civil penalty regime.<sup>225</sup> Quite simply, it is unrealistic to expect manipulation to be routinely prosecuted in the way required for civil penalties to be effective.

In assessing the appropriateness of classifying manipulation as a crime, the anti-manipulation prohibition must be placed in the broader financial market regulatory context. The prevalence of manipulation largely depends on whether the manipulator's expected profit outweighs the potential cost of being caught and punished.<sup>226</sup> It follows that deterring manipulation depends not only on an effective prohibition, but also on the regulatory framework minimising opportunities for profitable manipulation.<sup>227</sup> For example, the continuous disclosure regime has played an important role in increasing price formation process transparency and thereby

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of Corporate Law Enforcement in Australia' (2009) 23 *Australian Journal of Corporate Law* 233, 237.

<sup>224</sup> Constable, 'Ferocious Beast', above n 1, 105.

<sup>225</sup> Ibid 94–95.

<sup>226</sup> Finkelstein, above n 223, 209; Kozinn, above n 67, 243; Ledgerwood and Carpenter, above n 201, 3.

<sup>227</sup> Shaun Ledgerwood, 'Triggers and Targets: The Anatomy of Market Manipulation' (Research Report, The Brattle Group, 22 July 2011) 6–7 <<http://ssrn.com/abstract=1893225>>.

limiting opportunities to manipulate poorly informed investors.<sup>228</sup> Similarly, surveillance efforts can focus on those markets most vulnerable to manipulation and the firms most likely to offend.<sup>229</sup> Conduct that is likely to be used for manipulative purposes, such as making false or misleading statements, can also be specifically prohibited. Finally, company directors and brokers are disproportionately likely to manipulate the market.<sup>230</sup> For this reason, they should be subject to obligations of loyalty and honesty to prevent them from abusing their position. Seen in this broader context, a criminal prohibition on manipulation has an important and complementary role.

The proposed regime might be criticised on the basis that criminal offences are more difficult to prove than civil penalties.<sup>231</sup> Indeed, critics might argue that the introduction of civil penalties<sup>232</sup> was intended to overcome difficulties of proving intention<sup>233</sup> — primarily by the application of the civil standard of proof,<sup>234</sup> the balance of probabilities.<sup>235</sup> A related criticism is that criminal prosecution is an ineffective, costly and slow method of deterring manipulation.<sup>236</sup>

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<sup>228</sup> Donald, above n 8, 64–67.

<sup>229</sup> Ledgerwood, above n 227, 6–7; Paul Constable, ‘Combating Stock Market Manipulation in Australia: Trading Scandals and the Lessons to Be Learnt’ (2013) 16 *International Trade and Business Law Review* 325, 337–38, 360, 361, 367, 370.

<sup>230</sup> Constable, ‘Combating Stock Market Manipulation’, above n 229, 337, 346.

<sup>231</sup> Ibid 333; Vicky Comino, ‘High Court Relegates Strategic Regulation and Pyramidal Enforcement to Insignificance’ (2005) 18 *Australian Journal of Corporate Law* 48, 55.

<sup>232</sup> *Corporations Act 2001* (Cth) ss 1317E(1)–(2), 1317G(1A).

<sup>233</sup> Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) 15.2.

<sup>234</sup> Michelle Welsh, ‘Eleven Years on — An Examination of ASIC’s Use of an Expanding Civil Penalty Regime’ (2004) 17 *Australian Journal of Corporate Law* 175, 183; Huang, above n 8, 12.

<sup>235</sup> *Corporations Act 2001* (Cth) ss 1317L, 1322.

<sup>236</sup> Constable, ‘Ferocious Beast’, above n 1, 88–90.

These criticisms are less forceful than they initially appear. Allegations of manipulation are extremely serious. As such, courts will require strong evidence to be satisfied to the civil standard of proof<sup>237</sup> — meaning that there is little, if any, practical difference from the criminal standard. Additionally, courts have limited the procedural and evidential differences between civil penalty and criminal proceedings because of a concern that civil penalties have a penal nature.<sup>238</sup> Furthermore, even if these criticisms were accurate, they are misplaced. Procedural and evidential safeguards appropriately protect the accused from being wrongly convicted of a serious crime.

### ***B Serious Financial Market Crimes Act***

The proposed anti-manipulation regime should be enacted in a new *Serious Financial Market Crimes Act 2014* (Cth). This Act will also contain prohibitions on other conduct that undermines financial market integrity, although this is beyond the scope of the thesis. Introduction of the Act will reframe manipulation as a serious criminal offence. This will combat any existing perception in the financial services industry or wider community that it is a technical, or perhaps trivial,<sup>239</sup> breach of an obscure section of the *Corporations Act 2001* (Cth).<sup>240</sup>

The new Act provides an opportunity for Parliament to critically reflect on its policy objectives for prohibiting manipulation and to articulate them in more detail than can be

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<sup>237</sup> *Briginshaw v Briginshaw* (1938) 60 CLR 336, 361–362; *Evidence Act 1995* (Cth) s 140.

<sup>238</sup> Comino, ‘High Court Relegates’, above n 231, 59; Joe Longo, ‘Market Misconduct Provisions of the Financial Services Reform Act: Challenges for Market Regulation’ (Paper, Centre for Corporate Law and Securities Regulation seminar on Market Misconduct and the Financial Services Reform Bill, Melbourne, 25 July 2001, and Sydney, 14 August 2001, 21; Duffy, above n 190, 155, 157.

<sup>239</sup> Barry Rider, ‘An Abominable Fraud?’ (2010) 31 *Company Lawyer* 197, 197.

<sup>240</sup> *Corporations Act 2001* (Cth) ss 1041A–1041C.

achieved in the *Corporations Act 2001* (Cth), within which manipulation is a small component. At present, Parliament's understanding of manipulation and the scope of liability under the current prohibitions is unclear. The policy objectives for prohibiting manipulation have been stated only at the high level of protecting investors from fraud and promoting market efficiency<sup>241</sup> and are capable of supporting different interpretations of the prohibitions. They imply different features of, and harm caused by, manipulation. It is crucial that Parliament uses this opportunity to articulate its policy objectives more clearly and in greater detail. This will help courts to develop sound case law and will enable the identification of novel manipulative techniques.<sup>242</sup> It will also assist investors in interpreting the scope of the prohibitions and will facilitate their compliance with the law.<sup>243</sup>

The current regime is the product of an ad hoc consolidation of the previous futures<sup>244</sup> and securities<sup>245</sup> regimes. This was necessitated by the Financial Services Reform Bill 2001 (Cth), which abolished the historical distinction between futures and securities regulation and uniformly regulated them as financial products.<sup>246</sup> Parliament seems not to have anticipated that this would result in a substantial change to the scope and nature of the prohibited

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<sup>241</sup> Australian Financial Centre Forum, 'Australia as a Financial Centre, Building on Our Strengths' (Report, November 2009) 1, 8–9; Goldwasser, 'Regulating Manipulation in Securities Markets', above n 35, 176; Walker and Fisse, above n 2, 165–66; Goldwasser, *Stock Market Manipulation*, above n 8, 47; Hart, above n 170, 139.

<sup>242</sup> Goldwasser, *Stock Market Manipulation*, above n 8, 91.

<sup>243</sup> Dan Awrey, 'Regulating Financial Innovation: A More Principles-Based Proposal?' (2011) 5 *Brooklyn Journal of Corporate, Financial and Commercial Law* 273, 285–88.

<sup>244</sup> *Corporations Act 1989* (Cth) ss 1259–1260.

<sup>245</sup> *Ibid* ss 997–998.

<sup>246</sup> Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) 2.7, 2.24, 2.75.

conduct,<sup>247</sup> but this has certainly been the effect of the reforms. This unintended outcome is a contributing factor to many of the regime's deficiencies, as discussed in the previous chapter. Having an Act that is dedicated to serious financial market offences will reduce the risk of this happening again. It will also contribute to generating a political impetus for substantive law reform, which may not otherwise exist.

Introduction of the *Serious Financial Market Crimes Act 2014* (Cth) will also positively impact the public, ASIC and the financial services industry. Media reporting is likely to be the public's major source of exposure to financial market regulation.<sup>248</sup> News reports of prosecutions brought pursuant to the new Act will reinforce public understanding that manipulation is a serious criminal offence that is strictly prohibited. This will enhance community perceptions that ASIC's enforcement actions are credible and effective.

This is crucial, given the public's diminished trust in financial markets and regulatory agencies<sup>249</sup> following the high-profile media reporting of manipulation and other market abuses during the global financial crisis.<sup>250</sup> Increased public confidence in financial market integrity will help maintain high levels of financial market participation. This will support

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<sup>247</sup> Longo, above n 238, 2; Goldwasser, 'Regulating Manipulation in Securities Markets', above n 35, 194.

<sup>248</sup> Mohamad Fazli Sabri, *Pathways to Financial Success: Determinants of Financial Literacy and Financial Well-being among Adults* (PhD Thesis, Iowa State University, 2011) 18, 58, 60.

<sup>249</sup> RBA Assistant Governor Guy Debelle, 'Some Effects of the Global Financial Crisis on Australian Financial Markets' (Speech delivered at the Finance Professionals Forum, Sydney, 31 March 2009); Alex Erskine, 'Rethinking Securities Regulation after the Crisis: An Economic Perspective' (Discussion Paper, ASIC, 9 July 2010) 1, 18; D'Aloisio, 'ASIC's Approach', above n 221, 12.

<sup>250</sup> Corporations and Markets Advisory Committee, above n 7, 7, 10; 'ASIC Unworthy', *The Australian Financial Review*, 1 February 2010; ASIC, 'Responsible Handling of Rumours' (Consultation Paper, Part 118, September 2009) 7–9.

high trading volumes and liquidity, which reduce opportunities for profitable price-impacting manipulation.<sup>251</sup>

The Act clearly indicates parliamentary approval for ASIC's policy of bringing targeted strategic prosecutions of high-profile manipulators.<sup>252</sup> This will promote a spirit of prosecutorial determination in ASIC's enforcement teams, bringing a renewed vigour to enforcement actions and combating the perception that ASIC is a toothless and ineffective regulator.<sup>253</sup> This will provide an important boost to ASIC's morale, given the reduced budgets and staffing over the next few years.<sup>254</sup>

Finally, the Act will remind companies in the financial services industry of the importance of having a robust anti-manipulation compliance system in place and will promote adequate monitoring of the system.<sup>255</sup> More generally, the Act will raise awareness of the importance of making business decisions with a pro-active attitude towards compliance. It will also enhance the prohibition's general deterrence effect by strongly signalling the seriousness of contravention.

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<sup>251</sup> Donald, above n 8, 77–78; Jean-Yves Delort et al, 'The Impact of Manipulation in Internet Stock Message Boards' (2011) 8 *International Journal of Banking and Finance* 1, 7.

<sup>252</sup> D'Aloisio, 'ASIC's Approach', above n 221, 8–10.

<sup>253</sup> Goldwasser, 'Regulating Manipulation in Securities Markets', above n 35, 192; Damien Reichel, 'Directors Caught in Expectation Gap', *The Australian Financial Review*, 9 November 2010; Patrick Durkin, 'Exit the Enforcer', *The Australian Financial Review*, 14 May 2011; Patrick Durkin, 'Outrage over ASIC Fine Deals', *The Australian Financial Review*, 27 December 2013.

<sup>254</sup> Durkin, 'Agencies Slashed and Abolished', above n 175.

<sup>255</sup> Constable, 'Combating Stock Market Manipulation', above n 229, 337–38.

## CONCLUSION

This thesis has made a sustained critique of the current anti-manipulation regime. It has shown that the regime is based on an unsound understanding of manipulation and consequently has an inappropriate scope of liability. The regime is also internally defective in several respects.

More significantly, the thesis has advanced two proposals for substantive law reform. First, it has argued that two criminal prohibitions on manipulation should replace the current regime. These provisions are predicated on a conceptually sound definition of manipulation and have an appropriate scope of liability. Additionally, they reposition manipulation as a serious criminal offence, while being easier to enforce than the current regime. Second, the thesis has argued that a *Serious Financial Market Crimes Act 2014* (Cth) should be enacted. It has shown that this will elevate the credibility of ASIC's enforcement efforts and provide an impetus for Parliament to specify its policy objectives in more detail.

These proposals can be supported by future research into practical aspects of implementation. It is recommended that research explore the competing policy objectives for prohibiting manipulation. It would be helpful to better understand how these relate to Parliament's overarching financial market regulatory objectives. This will enable Parliament to make informed policy trade-offs when designing the regulatory mix. Research should also investigate practical reform options, such as to ASIC's evidence-gathering powers, trial procedures and market surveillance technology. The result of such investigations will assist in the effective implementation and practical enforcement of the proposed regime.

The proposals advanced in this thesis will form the basis of a robust regulatory framework to effectively deter manipulation. They will promote widespread public confidence in the integrity of Australian financial markets. Most importantly, they will significantly contribute to the reputation of the markets as being fair, efficient and transparent and thus maximise their contribution to the economy. The reforms should be adopted without delay.

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## APPENDIX

### Appendix 1

The following table defines several of the most common manipulative techniques. It is not intended to be exhaustive.

Technique	Definition
<b>Market Activity Manipulation</b>	
Organised run	The manipulator enters transactions at successively higher prices to create an appearance of active buying interest, so as to induce other investors to purchase the security at an inflated price ('pump and dump'). The transactions may be accompanied by false rumours of positive news that are intended to exacerbate the price increase ('hype and dump'). <sup>256</sup>
Pool	A group of manipulators acquire shares, and then trade them between themselves to create a false appearance of active trading. <sup>257</sup>
Churning	In Australia, it refers to a situation where a manipulator acquires

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<sup>256</sup> Redmond, above n 26, 922-923.

<sup>257</sup> Ibid.

	shares and then places both buy and sell orders at the same time, and often at slightly increasing prices, to create the impression of active turnover. In America, it refers to the practice of brokers, who use control over their client's accounts to make excessive transactions for the purpose of increasing their commission. <sup>258</sup>
Wash sale	The manipulator acquires a security and then simultaneously offers to buy and sell it. Although a trade is reported to have occurred, there is no change in beneficial ownership of the security. <sup>259</sup>
Matched order	The manipulator and an associate enter purchase and sale orders for a security at substantially the same price and substantially the same volume. <sup>260</sup>
Ping order	The manipulator places a bid or makes an offer, with the intention of immediately cancelling it prior to execution. The purpose is to trigger other traders to react, thereby revealing information about their position and allowing the manipulator to profitably trade. <sup>261</sup>
Quote stuffing	The manipulator submits a large number of orders with the intention to cancel them prior to execution. The purpose is to slow

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<sup>258</sup> Ibid.

<sup>259</sup> Ibid.

<sup>260</sup> Ibid.

<sup>261</sup> ASIC Commissioner Shane Tregillis, 'ASICs agenda for market integrity' (Speech delivered at the Supreme Court Corporate Law Conference, Sydney, 2011) 11-12.

	the processing of orders, thereby creating uncertainty for other traders and allowing the manipulator to profitably trade. <sup>262</sup>
Momentum Ignition	The manipulator makes aggressive trades for purpose of starting or exacerbating a trend and then trading profitably from it. <sup>263</sup>
Spoofing	The manipulator places limit orders to sell at a price above the best asking price, with the intention of canceling the orders prior to execution if prices move upward. The purpose is to induce other traders to sell, allowing the trader to buy at a reduced price. <sup>264</sup>
<b>Price Manipulation</b>	
Ramping	The manipulator makes bids, or buys shares, at or near the close of trading in order to achieve a specific closing price. ‘Window dressing’ is ramping by a fund manager to enhance the apparent performance of an investment portfolio. <sup>265</sup>
Corner	The manipulator acquires dominant, or monopoly, power in a commodity and large ownership in a related long futures contract.

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<sup>262</sup> Prewitt, above n 28, 147-148.

<sup>263</sup> Tregillis, above n 261, 11-12.

<sup>264</sup> John L Teall, *Financial Trading and Investing* (Academic Press, 1st Ed, 2013) 333.

<sup>265</sup> Redmond, above n 26, 922-923.

	This market power is used to extract an artificially high settlement price from short sellers. <sup>266</sup>
Squeeze	A natural commodity shortage allows the holder of long futures contracts to take advantage of short sellers by extracting an artificially high settlement price. <sup>267</sup>
Rumourtrage	The manipulator seeks to reduce the price of a security by spreading rumors of negative news about the company and then profiting from either short selling the security or purchasing the security at reduced prices. <sup>268</sup>

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<sup>266</sup> *Director of Public Prosecutions (DPP) (Cth) v JM* (2012) 267 FLR 238 at [325].

<sup>267</sup> *Ibid* at [324].

<sup>268</sup> 'Aspects of Market Integrity' (Report, Corporations and Markets Advisory Committee, June 2009) 7, 10.

## Appendix 2

The physical and fault elements that the prosecution must prove at trial under the current and proposed regimes is deconstructed in the table below.

Physical Element	Implied Fault Element for Criminal Prosecution
<b>Section 1041A</b>	
<ul style="list-style-type: none"> <li>The person took part in, or carried out, one or more transactions.</li> </ul>	<ul style="list-style-type: none"> <li>The person <i>intended</i> to take part in or carry out the relevant transaction(s).<sup>269</sup></li> </ul>
<ul style="list-style-type: none"> <li>The transaction or transactions had the effect or were likely to have the effect of creating or maintaining an artificial price.</li> </ul>	<ul style="list-style-type: none"> <li>The person was <i>reckless</i> as to whether the transaction(s) would create or maintain an artificial price or would be likely to create or maintain an artificial price.<sup>270</sup></li> </ul>
<b>Section 1041B</b>	
<ul style="list-style-type: none"> <li>The person did, or omitted to do,</li> </ul>	<ul style="list-style-type: none"> <li>The person <i>intended</i> to do the act or</li> </ul>

<sup>269</sup> A person has intention with respect to conduct if he or she means to engage in that conduct: *Criminal Code 1995* (Cth) sch 1 s 5.2(1).

<sup>270</sup> Recklessness can be established by proving intention, knowledge or recklessness: *Criminal Code 1995* (Cth) sch 1 s 5.4(4). A person is reckless with respect to a result if he or she is aware of a substantial risk that the result will occur; and having regard to the circumstances known to him or her, it is unjustifiable to take that risk: *Criminal Code 1995* (Cth) sch 1 s 5.4(2). A person has knowledge of a circumstance or result if he or she is aware that it exists or will exist in the ordinary course of events: *Criminal Code 1995* (Cth) sch 1 s 5.3.

an act.	omit to do the act.
<ul style="list-style-type: none"> <li>The act or omission caused the proscribed effect or was likely to cause the proscribed effect.</li> </ul>	<ul style="list-style-type: none"> <li>The person was <i>reckless</i> as to whether the act or omission would have or would be likely to have the proscribed effect.</li> </ul>
<b>Section 1041C</b>	
<ul style="list-style-type: none"> <li>The person entered into, or engaged in, a fictitious or artificial transaction or device.</li> </ul>	<ul style="list-style-type: none"> <li>The person <i>intended</i> to enter into, or engage in, a fictitious or artificial transaction or device.</li> </ul>
<ul style="list-style-type: none"> <li>The transaction or device resulted in the price for trading in a financial product fluctuating, or being maintained, inflated or depressed.</li> </ul>	<ul style="list-style-type: none"> <li>The person was <i>reckless</i> as to whether the transaction or device would cause the price to fluctuate, be maintained, inflated or depressed.</li> </ul>
<b>Proposed Trade-Based Prohibition</b>	
<ul style="list-style-type: none"> <li>The person entered into, or engaged in, one or more transactions.</li> </ul>	<ul style="list-style-type: none"> <li>The person <i>intended</i> to enter into, or engage in, one or more transactions.</li> </ul>
	<ul style="list-style-type: none"> <li>The transaction was entered into, or engaged in, for the <i>dominant purpose</i> of manipulating the market for, or price of, a financial product.</li> </ul>

<b>Proposed Conduct-Based Prohibition</b>	
<ul style="list-style-type: none"><li>• The person did, or omitted to do, an act.</li></ul>	<ul style="list-style-type: none"><li>• The person <i>intended</i> to do, or omit to do, an act.</li></ul>
	<ul style="list-style-type: none"><li>• The act, or omission to act, was done for the <i>dominant purpose</i> of manipulating the market for, or price of, a financial product.</li></ul>