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Market manipulation: s 1041A and the sole or dominant purpose test, revisited

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Section 1041A of the *Corporations Act 2001* (Cth) (Act) prohibits any person from taking part in or carrying out a transaction that has or is likely to have the effect of creating or maintaining an artificial price for financial products on a financial market. The provision has attracted increased scrutiny in the wake of the 'Bank Bill Swap Rate' (BBSW) cases, which directs attention towards the test derived from the High Court's decision in *Director of Public Prosecutions (Cth) v JM* (2013) 250 CLR 135 (*JM*) as to when a transaction will have the impugned effect. In the BBSW cases, ASIC alleged that several large banks had manipulated the market for trading in prime bank bills.¹ Trading in prime bank bills informed the setting of the BBSW, a benchmark interest rate. The effect

of the trading – it was said by the regulator – was that it created or maintained an artificial price for certain financial products that were set by reference to that rate.

ASIC also alleged that the Banks' 'sole or dominant purpose' was to engage in trades to that effect. The 'sole or dominant purpose' test was drawn from the High Court's decision in *JM*. In that case, the test was proffered by the DPP, and accepted by the Court, as a way in which the effects element of section 1041A – that is the effects of creating or maintaining an artificial price for financial products – may be satisfied. In *JM*, the accused had borrowed money to exercise some options in a company. The underlying shares were to be used as security for the loan. To the extent the shares fell below a certain price,

the lender was entitled to issue a margin call requiring *JM* to provide additional security for the loan. *JM* then procured his daughter to purchase shares in the company, ensuring that the price never fell below the level at which the lender could make the call.

The High Court held that the 'effect' of creating or maintaining an artificial price could be proven by demonstrating that the manipulator had the sole or dominant purpose of achieving that effect. This was because, '[w] here a person has the sole or dominant purpose of setting a price at a particular level, that price does not reflect forces of genuine supply and demand in an open, informed and efficient market'.² The forces of genuine supply and demand are those forces which are created in a market 'by buyers whose purpose is to acquire at the lowest available price and sellers whose purpose is to sell at the highest realisable price'.³

On one level, the decision in *JM* simplified the task for proving market manipulation allegations. That is, theoretically, it provided a means by which to prove the effects element of market manipulation without reference to an expensive and detailed forensic analysis, demonstrating that the impugned transactions did in fact create or maintain an artificial price.

But the decision in *JM* has also generated some significant complications – and likely unintended consequences – in the application of section 1041A.

First, section 1041A contains no express intention element. The decision in *JM* allowed for price effects to be proven by adducing evidence of the subjective purposes of the contravener; or at least that from such purposes, one could draw an inference of effect on price.⁴ Either way, it changed the scope of the evidentiary burden in a way that is not expressly articulated in the provision itself.⁵ This appears out of step with provisions that are similar to, or preceded, section 1041A: see, for example, former sections 997 and 1259 of the Act, section 70 of the *Security Industry Act 1970* (NSW), and section 130 of the *Futures Industry Act 1986* (Cth), all of which contained 'intention' elements.⁶

The reasoning in *JM* may also be contrasted with the approach taken in other areas of the law where effects-based proscriptions operate. Competition lawyers, for example, are accustomed to proving that impugned conduct has had the effect or likely effect of substantially lessening competition. Market effects of restrictive trade practices cannot be proven simply by demonstrating the nefarious purposes of the market participants (although nefarious purposes might reveal the intended effects of the impugned conduct). Where purpose is relevant and effects need not be proven – for example, in relation to s 45AD of the *Competition and Consumer Act 2010* (Cth) – the provisions are expressly framed as such (reflecting the

public policy position that certain collusive conduct between horizontal competitors is considered so pernicious as to not require a demonstrated effect on competition in the relevant market).

Second, if 'sole or dominant purpose' is used to demonstrate market effects, determining whose purpose is relevant will not always be straightforward. In the context of corporate liability, questions of agency, and who holds the directing mind and will of a company, will become relevant; that is, if an employee or officer of a corporation engages in a transaction with the requisite purpose, whether that purpose can be imputed to that corporation. It also raises issues in relation to accessory liability. In last year's decision of *Gore v Australian Securities and Investments Commission* (2017) 249 FCR 167, the Full Federal Court held that – in order to make a finding of accessory liability pursuant to s 79 or s 1324(1) of the *Corporations Act 2001* – it must be shown that a defendant had knowledge of all the elements of the primary contravention. In the context of section 1041A, this includes knowledge of the sole or dominant purpose of the primary contravener. In circumstances, for example, where a stockbroking firm employs a 'rogue trader', the stockbroking firm may need to have had knowledge of the trader's sole or dominant purpose in order to be accessorially liable.

Third, in criminal market manipulation proceedings, the sole or dominant purpose test may be difficult to reconcile with the *Criminal Code Act 1995* (Cth) (Code).⁷ Section 5.6 of the Code provides that, if the law creating an offence does not specify a fault element for a physical element that consists of a circumstance or a result, recklessness is the requisite fault element. For an effects provision like section 1041A, this begs the question of how a Court is supposed to apply both the sole and dominant purpose test, and a recklessness standard to determine whether the fault element has been met.

This issue arose in the Victorian case of *R v Jacobson*, [2014] VSC 368, in relation to market manipulation allegations. There, the Victorian Supreme Court observed that there was 'a necessary inconsistency between the conduct element (taking part in a transaction with the sole or dominant purpose of setting or maintaining an artificial price for GTG shares) and the fault element (being reckless as to whether the transaction had that effect)'.⁸ The issue was not resolved, because the parties, between themselves, agreed on the elements of the criminal case that the prosecution would be required to prove.⁹

Fourth, the test may not be appropriate in circumstances where the manipulation of the price of one product (or benchmark rate) is intended to have some desired effect on the price of another product. ASIC's case in the Westpac BBSW Case was premised on traders holding the relevant sole or dominant purpose

in respect of trading in Prime Bank Bills, to achieve a particular setting of the BBSW, resulting in an artificial price for certain financial products, being BAB futures, interest rate swaps and cross-currency swaps.¹⁰ Significant in Beach J's reasoning in the case was the disconnect between the sole or dominant purposes of traders in respect of Prime Bank Bills, or BBSW, and whether that sole or dominant purpose was directed to, or achieved, in relation to those ultimate financial products whose prices were referable to that rate.¹¹ If the case were premised on showing 'effects' alone, the question of where a person's purpose is directed becomes moot.¹²

Finally, under *JM*, a person can contravene section 1041A by engaging in a transaction with the requisite purpose, irrespective of whether their conduct has had any *actual* effect on the price for those securities. The absence of evidence of such effects may be relevant to penalty. In the case of *Heath v R* [2016] NSWCCA 24 the NSW Court of Appeal considered a sentence following a guilty plea on charges for s 1041A conduct. Before the sentencing judge, the appellant had given evidence that his trading had achieved no lasting price impact on the relevant stocks, and he was not able to take advantage of any short term price impact his trading had caused. The Court of Appeal determined that the sentencing judge, in assessing the objective seriousness of the crime, had 'overlooked or misapprehended the fleeting impact of the applicant's trading on the market and the unlikelihood that he would in fact obtain any lasting financial benefit as a result of his trading'.¹³ In a statement of agreed facts, the appellant had admitted that he undertook each of those transactions for the sole or dominant purpose of maintaining or increasing the price of the shares. As the Court noted, however, 'that purpose could never have been achieved by trading at the volume and frequency of the applicant's trading'.¹⁴

Certainly the sole or dominant purpose test effectively presupposes that the ulterior motive of a trader is what actually renders a price artificial.¹⁵ Nevertheless, the approach of the Court of Appeals in *Heath* does not resolve the fundamental difficulty of the ruling in *JM*: that the effects requirement of s 1041A might be satisfied absent proof of effects.¹⁶ Beach J has cautioned that 'no part of s 1041A expressly authorises me to substitute and treat as conclusive the subjective motivations of an individual trader for the 'effect' of the transaction' and that the test was not some separate element of a market manipulation offence. Rather, it is just one source of information from which to prove effects.¹⁷ His Honour also noted that the *ratio* in *JM* was directed to transactions of a particular kind; that is, on-market transactions in ASX-listed shares. The ubiquity or importance of the sole or dominant purpose test in market

manipulation proceedings should therefore not be overstated. Nevertheless, there are several unresolved aspects of the test for section 1041A, and it is likely attended by some level of uncertainty for the foreseeable future.

END NOTES

- As described by Beach J, in the recent decision of *Australian Securities and Investments Commission v Westpac Banking Corporation (No 2)* [2018] FCA 751 (*Westpac BBSW Case*), prime bank bills are prime bank-accepted bills of exchange, that are instruments by which banks may either borrow or lend funds for a short term. Prime Banks are certain banks elected and recognised as such, pursuant to a process of election and recognition specified by AFMA. Trading in Prime Bank Bills inform the setting of the BBSW, which is the key benchmark interest rate in Australian financial markets and which provides a reference (i.e. pricing) rate for a range of futures, interest rate swaps and cross-currency swaps. .
- Ibid* at [72].
- Ibid* at [71].
- Cf. *ibid* at [1958].
- There may be good public policy reasons for the decision. For example, transparency between buyers and sellers; and the 'efficient allocation of capital and preservation of market confidence': ASIC Report 440, July 2015 at [59]. But it is nevertheless a curious result for a provision that contains no express mental element.
- The majority decision was based in part on Mason J's reasoning in *North v Marra Developments* (1981) 148 CLR 42, with respect to section 70 of the *Securities Industry Act* (NSW). But section 70 prohibited persons from doing anything 'which is calculated to create a false or misleading appearance of active trading.' That is, there was arguably an intention-element in the provision that is not evident in s. 1041A. The High Court in *JM* also contrasted the position in relation to the futures commodities context and section 130 of the former *Futures Industry Act 1986* (Cth). But again, that provision prohibited persons from engaging in 'transactions intended to have, or likely to have, the effect of' creating an artificial price for dealing in futures contracts on a futures market'. See also, Beech J in the *Westpac BBSW Case* at [1918].
- Notably, the Full Federal Court in *Australian Securities and Investments Commission, in the matter of Whitebox Trading Pty Ltd v Whitebox Trading Pty Ltd* [2017] FCAFC 100, determined that the *Criminal Code* was not applicable in civil penalty proceedings, but it nevertheless will be applicable in criminal penalty proceedings.
- Ibid*, at [122].
- That is, (i) that the accused intentionally took part in or carried out the transaction and (ii) that his sole or dominant purpose in so doing was to set or maintain the price of the securities at a particular level: at [122].
- Westpac BBSW Case* at [24].
- Ibid*, at [1962].
- Ibid* at [1989].
- Ibid* at [61] – [63].
- Ibid* at [63].
- ASIC proceeded at some points in a slightly different way in the *Westpac BBSW Case*; that is, on the basis that conduct engaged in with the intention of achieving a particular outcome may properly be inferred to have achieved that outcome: *ibid* at [1947]; cf at [1951]. This is a slightly different proposition to the reasoning in *JM*, that a lack of bona fides on the part of a buyer or seller in a particular transaction will effectively render a price – by definition – artificial.
- Beach J noted that he agreed 'that it does not matter whether the yield or price accords with true value or is set at a reasonable level because of trading with a sole or dominant purpose of affecting price or yield. I also accept that it does not matter whether the trader's intention is to correct or to manage a price or yield or to oppose or counteract manipulative trading in the opposite direction. Such conduct where a buyer is not concerned to buy at the lowest price and a seller is not concerned to sell at the highest price is necessarily a distortion of the interaction of market forces of supply and demand': *Westpac BBSW Case* at [1930].
- Ibid*, at [1957]-[1958].