SUBMISSION TO CAMAC
Aspects of Market Integrity – Issues Paper

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This submission only relates to the issues raised in Section 3.3 of the Issues Paper

Initiating rumours (Section 3.3)

(1) the implications for market integrity of rumour-mongering.

The spreading of rumours impacts on market integrity as it runs contrary to one of the fundamental principles of securities laws that the market should be fair, efficient and transparent.[1] Sections 1041E, 1041F and 1041G of the *Corporations Act 2001* (Cth) (Corporations Act) already prohibit the spreading of false or misleading rumours. The spreading of rumours which are true is also of concern as it suggests insider trading and/or companies failing to comply with their continuous disclosure obligations. The recent problems with rumour-mongering suggest that the existing laws are not operating effectively. The reason seems to be, not generally with the wording of the statute (although some suggested improvements are set out below), but with a failure to enforce these prohibitions. With limited enforcement the law is not acting as an effective deterrent to engaging in this type of behaviour.

Accordingly the solution would seem to lie in enhancing enforcement of the existing prohibitions. A number of studies have shown that effective enforcement of securities laws is fundamental to market integrity.[2] Effective enforcement may also result in more dispersed equity ownership, greater stock price accuracy and greater liquidity.[3]

(2) Should all or some of ss 1041E, 1041F and 1041G be civil penalty provisions as well as attracting criminal liability

For consistency with other market manipulation provisions in the Corporations Act Section 1041E should be a civil penalty provision. This would give ASIC the flexibility to bring civil penalty action if it does not believe that it can prove the mental element of the offence.

Furthermore the knowledge element in s.1041E(c) should be removed as it is unnecessary given the application of the *Criminal Code 1995* (Cth) (the Code) to the Corporations Act. As the Code applies the prosecution would have to prove intention,

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[1] IOSCO Objectives and Principles of Securities Regulation (May 2003) at para 4.1, available online at www iosco.org.

[2] See for example Bhattacharya, U. and H. Daouk, 2002, "The World Price of Insider Trading", Journal of Finance 57 and Hail, L. and C. Leuz, 2005, "International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?", (ECGI - Law Working Paper No. 15/2003) http://ssrn.com/abstract=641981.

[3] L N Beny "Insider Trading Laws and Stock Markets Around the World; An Empirical Contribution to the Theoretical Law and Economics Debate" (2007) 32(2) Journal of Corporation Law at 237.

knowledge or recklessness in relation to each of the physical elements of this prohibition to prove this as a criminal offence.[4]

Section 1041F should also be amended, removing dishonesty and making it a civil penalty prohibition. For example it could provide:

> A person must not induce another person to deal in financial products:
> (a) by making or publishing a statement, promise or forecast which is false, misleading or deceptive;
> (b) by the concealment of material facts; or
> (c) by recording or storing information which is false or misleading in a material particular if;
> (i) the information is recorded or stored in, or by means of a mechanical, electronic or other device; and
> (ii) when the information was so recorded or stored, the person had reasonable grounds for expecting that it would be available to the other person, or class of persons that includes the other person.

Again with the application of the Code to the Corporations Act the prosecution would have to prove intention, knowledge or recklessness in relation to each of these physical elements to prove this as a criminal offence.

Section 1014G should remain a criminal offence given central 'moral blameworthy' element of dishonesty in this offence. However the test for dishonesty prescribed in s 1041G should be removed. This is because this test, derived from the UK case of *R v Ghosh* [1982] QB 1053, is inconsistent with the test for dishonesty in other provisions in the Corporations Act and inconsistent with the application of the Code to the Corporations Act. No other provision in the Corporations Act which contains dishonesty as an element, except for s.1041F and s.1041G, has a test for dishonesty prescribed within the section.[5]

In relation to those provisions in the Corporations Act where no test for dishonesty is prescribed, the test is similar, but not identical to, the *Ghosh* test. Dishonesty is a "physical element" under the Code, being a "circumstance" in which conduct occurs.[6] Although the Code does not make it clear, presumably as a result of the test set out by the High Court *Peters v The Queen* (1998) 192 CLR 493, the finder of fact (a jury or magistrate) would have to find that the conduct was dishonest in accordance with the standards of ordinary, decent people. In addition, as with any physical element where the Code applies, there is a prescribed "fault element", in this case recklessness.[7] Accordingly the finder of fact would also have to find that the defendant must either have known that the conduct would be dishonest in accordance with the standards of ordinary people, or was at least aware that there was a substantial risk that the conduct would be dishonest in accordance with the standards of ordinary people.[8]

(3) Should any of the elements of any of these three provisions be amended and, if so in what manner

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[4] *Criminal Code* (Cth) s 5.4 and 5.6.
[5] For example *Corporations Act* 2001 (Cth) s 588G(3), s 260D(3) and s 256D(4).
[6] *Criminal Code* (Cth) s 4.1(1).
[7] *Criminal Code* (Cth) s 5.6(2).
[8] *Criminal Code* (Cth) s 5.4.

See response to issue 2 above.

(4) Should some form of compulsory recording of telephone conversations and other electronic forms of communication, such as SMS, be introduced

Compulsory recording of telephone conversations and other electronic forms of communication should not be introduced. Introducing such a system would be costly and limited to certain lines. In order not to contravene the provisions of the *Telecommunications (Interception and Access) Act 1979* (Cth) (TI Act), it would have to be made clear to the parties to the conversation that they were being recorded.[9] Accordingly it is unlikely that those persons spreading false rumours would use telephones on which they know they are being recorded.

A more effective mechanism would be to amend the TI Act to allow ASIC to obtain a warrant to intercept telephone or other electronic communications in relation to an investigation into the market misconduct and insider trading provisions in Part 7.10 of the Corporation Act. Interception without a warrant is prohibited by s.7 of the TI Act. The power to apply for such a warrant is contained in s 39 of the TI Act. Under this section an "enforcement agency", as defined, can apply to a Judge of the Federal Court or a member of the Administrative Appeals Tribunal (AAT) for a warrant in respect of a particular telecommunication service or in respect of services which may be used by a particular person. ASIC is not however an "enforcement agency" within the definition contained in s 5 of the TI Act. Nor is it possible for any of the enforcement agencies listed within that definition, such as the Australian Federal Police, to obtain a warrant in respect of any of the relevant market misconduct offences in the Corporations Act. This is because s 46 of the TI Act provides that the Judge or AAT member may issue a telecommunications interception warrant on the application of an agency only when they are satisfied that information would be likely to be obtained to assist in connection with the investigation of a "serious offence". None of the market misconduct offences currently fall within the definition of "serious offence" in s 5D of the IT Act.

The government has recently introduced legislation into Parliament which would allow the Australian Competition and Consumer Commission (ACCC) to obtain such interception warrants in relation to the investigation of the new provisions to be introduced in the Trade Practices Act 1974 (Cth) which make it a criminal offence to form a cartel. The stated reason why this power is needed is that:

> Cartels are generally covert arrangements. Discovery and proof of the existence of a cartel is more difficult than other forms of corporate misconduct, justifying such powers to penetrate the cloak of secrecy.[10]

Market manipulation (including the spreading of false rumours) and insider trading are also usually undertaken under a cloak of secrecy with the perpetrators difficult to identify. It can be difficult to detect and there may be no documentary trail.

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[9] See s 6 of the *Telecommunications (Interception and Access) Act 1979* (Cth).

[10] Media Release 27 October 2008 by Hon Chris Bowen Mp Assistant Treasurer "Rudd Government to Introduce Legislation Criminalising Cartels" http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/087.htm&pageID=003&min=ceb&Year=&DocType= viewed 12 December 2008.

If ASIC was able to obtain a warrant to intercept electronic communication this may result in very significant evidence. In the absence of such evidence ASIC is often left in the exceptionally difficult position of having to try and make out a circumstantial case where it may be able prove that telephone calls were made, but has no evidence as to what was said.

Furthermore granting ASIC the power to seek a warrant under the TI Act would act as a better deterrent than compulsory recording of telephone conversations as perpetrators would not be aware or able to find out if their conversations, on any line, were being recorded.

(5) Any other steps to facilitate the detection and prosecution of rumour-mongering

Another possible mechanism that has been suggested to facilitate the detection and prosecution of market manipulation is granting immunity for participants in offences who 'blow the whistle' on the activity.

The ACCC currently has a policy whereby an individual or a corporation who is involved in a cartel can be granted immunity from civil proceedings provided they are the first person to report the activity to the ACCC, they are not the leader of the cartel and they did not coerce others to join the cartel.[11] On 1 December 2008 the ACCC and the Commonwealth Director of Public Prosecutions announced a Memorandum of Understanding which has the effect that the same criteria will apply to criminal prosecutions when the new cartel offence provisions are enacted.[12]

In a recent article "An immunity policy of Insider Trading and Market Manipulation"[13] Brent Fisse considered whether an immunity policy similar to the ACCC should be introduced by ASIC for market offences. He argues it is difficult to justify why, if such a policy is available for cartel offences it should not be available market offences:

> It is difficult to distinguish insider trading from cartel conduct on the basis that the conduct is easier to detect. Market manipulation may be easier to detect given the record of trades from which patterns of manipulation may be discerned but difficulty nonetheless arises.
>
> Nor does it seem plausible to attempt a distinction on the basis of the actual or likely harm to market integrity is less significant in impact than the actual or likely harm to competitive markets from cartel conduct.[14]

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[11] See *ACCC Immunity Policy for Cartel Conduct*, 26 August 2005 http://www.accc.gov.au/content/index.phtml/itemId/708758 viewed 12 December 2008.

[12] "ACCC and CDPP Outline Arrangements for Cartel Conduct Immunity" 1 December 2008, http://www.cdpp.gov.au/Media/Releases/20081201-ACCC-and-CDPP-Outline-Arrangements-for-Cartel-Conduct-Immunity.pdf and draft "Memorandum of Understanding between the Commonwealth Director of Public Prosecutions and the Australian Competition and Consumer Commission regarding Serious Cartel Conduct", http://www.cdpp.gov.au/Media/Releases/20081201-ACCC-and-CDPP-Cartel-Conduct-Immunity-MOU.pdf viewed 12 December 2008.

[13] B Fisse "An Immunity Policy for Insider Trading and Market Manipulation?" LCA Corporations Workshop 20-21 September 2008 http://www.brentfisse.com/images/AN_IMMUNITY_POLICY_FOR_INSIDER_TRADING_AND_MARKET_MANUPULATION_LCA_210908.pdf viewed 12 December 2008.

[14] Fisse, n 13 at 6.

Fisse also points to the fact that the US Securities Exchange Commission has a leniency policy and the UK Financial Services Authority has a policy of considering cooperation in deciding whether or not to prosecute an individual for market misconduct.[15]

Whilst such a leniency policy may result in the detection of more market misconduct, by itself, it may prove to be an imperfect mechanism to foster successful enforcement action by ASIC. Without adequate corroboration, it is doubtful that evidence given by the person granted immunity (who would in other circumstances be a co-accused) as to the involvement of another will be sufficient for ASIC to be able to establish a prima facie case. Furthermore, in criminal trials the value of such evidence is lessened by the fact that a jury is likely to be given a warning that such evidence may be unreliable, be told the reasons why it may be unreliable and that the jury must exercise caution in using it to convict an accused.[16] Even if ASIC brings civil penalty proceedings, instead of a criminal prosecution, courts have repeatedly stressed that given the seriousness of the consequences for a defendant in such proceedings, a high level of satisfaction is required to find such a contravention.[17] Evidence of a co-offender without adequate corroboration is unlikely to satisfy this test.

Nevertheless an immunity or leniency policy should be considered to ensure that ASIC is equipped with equivalent powers and tools to those used by equivalent regulators around the world to ensure a more consistent and coordinated enforcement response. In addition if there is an immunity or leniency policy and ASIC is given telephone intercept powers, ASIC may be able to use telephone intercepts to obtain the corroboration necessary to secure a conviction. This combination of investigation techniques has the potential to become a powerful tool for ASIC to fight market misconduct.

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[15] Fisse, n 13 at 2.
[16] See for example *Evidence Act 1995* (NSW) s 165.
[17] See for example *Adler v ASIC* (2003) 46 ACSR 505 at 534; *ASIC v Loiterton* [2004] NSWSC 172 at [10]; *ASIC v Vines* [2002] NSWSC 1223 at [20].