Case Notes

Defining an 'Artificial Price' Under s 1041A of the *Corporations Act*: *Director of Public Prosecutions (Cth) v JM* (2013) 298 ALR 615

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I INTRODUCTION

In *Director of Public Prosecutions (Cth) v JM* ('*JM*')[1] the High Court considered the market manipulation provision in s 1041A of *Corporations Act 2001* (Cth) ('the *Act*') for the first time. Specifically, the High Court considered the meaning of 'artificial price' and 'creating (or maintaining) an artificial price for trading.'[2] In their decision, the High Court adopted reasoning consistent with the interpretation of the lower courts, flowing from the decision of *North v Marra Developments* ('*North*'),[3] that had persevered up until the Victorian Supreme Court of Appeal ('VSCA') adopted a narrow approach in *Director of Public Prosecutions (Cth) v JM* ('*JM (VSCA)*').[4] The High Court held that an 'artificial price' for the purposes of s 1041A is a 'price that results from a transaction in which one party has the sole or dominant purpose of setting or maintaining the price at a particular level [and does not reflect] the forces of genuine supply and demand in an open, informed and efficient market.'[5] The High Court rejected the narrow construction given to s 1041A by the VSCA, which was heavily influenced by the US jurisprudence, exemplified by the decision in *Cargill, Inc v Hardin* ('*Cargill*').[6] Additionally the Court reiterated the independent application

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[1] (2013) 298 ALR 615; [2013] HCA 30; (2013) 87 ALJR 836; 94 ACSR 1; [2013] ALMD 3223; [2013] ALMD 3249 (*JM*). Note that this case note is restricted largely to the issues regarding the interpretation of s 1041A of the *Corporations Act 2001* (Cth), and does not consider the procedural issues under the *Criminal Procedure Act 2009* (Vic).

[2] *Corporations Act 2001* (Cth) ss 1041A(c) and (d).

[3] (1981) 148 CLR 42.

[4] (2012) 267 FLR 238.

[5] *JM* (2013) 298 ALR 615, [72].

[6] 452 F (2d) 1154 (1971).

of the provisions in Div 2 of Pt 7.10 of the *Act*,[7] in contrast with the 'watertight compartment' approach posited by the VSCA.

Unfortunately, the High Court did not elaborate on the parameters of their broad construction of s 1041A, specifically whether market stabilisation activities[8] associated with initial public offers ('IPOs') are in breach of s 1041A. Therefore, it remains unclear whether, despite the Australian Securities and Investments Commission ('ASIC') practice of issuing no-action letters, market stabilisation transactions can be challenged on the basis of illegality.[9] This is a concern because it leaves a cloud of doubt over the legitimacy of these transactions, doubt that does not exist in other advanced market economies.[10]

II BACKGROUND TO THE APPEAL

A *Facts*[11]

JM was at all times the CEO and a director of an Australian Stock Exchange ('ASX') listed company referred to in the proceedings as X Ltd. In September 2011 the Commonwealth Director of Public Prosecutions ('CDPP') presented an indictment alleging 39 counts of market manipulation under s 1041A of the *Act* as well as two associated counts of conspiring with others to commit market manipulation. All of the counts of market manipulation were alleged to have taken place in September and October 2013. It was alleged by the CDPP that JM, via an associated entity, had borrowed money in order to exercise a number of call options[12] for shares in X Ltd. In 2005 Z ApS, a Danish company associated with the accused, exercised a number of call options for X Ltd

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[7] *JM* (2013) 298 ALR 615, [64] – largely in reliance on s 1041J of the *Act*.

[8] Market stabilisation is the purchase of, or the offer to purchase, securities for the purpose of preventing, or slowing, any fall in the market price of those securities following an offer of those securities. An offer of securities often leads to a fall in the price of those securities because of: (a) the sudden increase in supply; and/or (b) imperfections in the pricing and allocation process. To counter this effect, the underwriter of the offer may attempt to stabilise the price of the securities by purchasing, or offering to purchase, the securities for a period after the issue or sale of the securities: Australian Securities and Investments Commission ('ASIC'), *Market Stabilisation* (Consultation Paper No 63, ASIC, March 2005) 3.

[9] As was the case in *North*, explained below.

[10] For example: §9a(6), *Securities and Exchange Act 1934* (US) and Rule 104 of Regulation M, Securities Exchange Commission 17 F.C.R. §242.104 (2003); s118(8), *Financial Services and Markets Act 2000* (UK) and MAR 2: Price Stabilising Rules, Financial Services Authority Handbook; and, s282 and 306, *Securities and Futures Ordinance* (Cap. 571) (HK).

[11] *JM* (2013) 298 ALR 615, [4]-[7]. See more detailed facts in *JM (VSCA)* (2012) 267 FLR 238, [7]-[25].

[12] A call option is a financial contract, which allows the buyer to purchase a share (or other financial instrument) at a certain price and at a certain time– but does not carry with it an obligation to do so.

shares, resulting in Z ApS becoming liable to X Ltd for the sum of $10m for the shares. To finance this, Z ApS entered a finance agreement ('the Opes facility') with Opes Prime Securities Pty Ltd ('Opes'). Z ApS used X Ltd options and shares as collateral for this agreement. The CDPP alleged shares were bought in X Ltd at 'a price and in circumstances that prevented the day's closing price for the shares falling below the point at which the lender to JM would make a margin call requiring JM to provide additional collateral for the loan.'[13]

B *Legal Context*

The main issue in *JM* was the construction of s 1041A.[14] Section 1041A is both an offence[15] and a civil penalty provision.[16] Section 1041A had its genesis in s 9(a)(2) of the *Securities Exchange Act 1934* (US), which influenced the development of s 123 of the former *Securities Industry Act 1980* (Cth), upon which ss 997 and 1259 of the former *Corporations Act 1989* (Cth) were designed.[17] Section 1041A was then introduced to replace ss 997 and 1259.[18]

One of the predecessors to s 1041A, s 70 of the *Securities Industry Act 1970* (NSW),[19] was considered by the High Court in *North,*[20] where it was held that the provision would be breached where 'purchases have

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[13] *JM* (2013) 298 ALR 615, [6].

[14] The case also considered the power to reserve questions of law under the *Criminal Procedure Act 2009* (Vic); however the focus of this case note is on the discussion of s 1041A of the *Act*.

[15] See *Corporations Act 2001* (Cth) s 1311(1).

[16] See *Corporations Act 2001* (Cth) s 1317E. Section 1041A of the *Act* provides: provides: A person must not take part in, or carry out (whether directly or indirectly and whether in this jurisdiction or elsewhere): (a) a transaction that has or is likely to have; or (b) 2 or more transactions that have or are likely to have;
the effect of: (c) creating an artificial price for trading in financial products on a financial market operated in this jurisdiction; or (d) maintaining at a level that is artificial (whether or not it was previously artificial) a price for trading in financial products on a financial market operated in this jurisdiction.

[17] As well as finding form in the state equivalents. See for example, *Securities Industry Act 1975* (Vic); *Securities Industry Act 1970* (WA).

[18] Explanatory Memorandum of to the Financial Services Reform Bill 2001, [15.12]; *JM (VSCA)* (2012) 267 FLR 238, [199]. See also, Butterworths, *Australian Corporation Law: Principles and Practice*, vol 3 (at 183) [7.13.0045]; CCH, *Australian Company Law Commentary* (at 2 August 2013) [278-050]. The difference between 997 and 1259 of the former Corporations Law was that s 1259 related only futures contracts, in contrast with s 997 which dealt with securities. The full history of s 1041A is provided in tabular form in *JM (VSCA)* (2012) 267 FLR 238, [201].

[19] Prior to national legislation, transactions on Australian stock exchanges were regulated by state legislation, such as s 70. It provided that, 'A person shall not create or cause to be created or do anything which is calculated to create a *false or misleading appearance of active trading* in any securities on any stock market in the State, or a false or misleading appearance with respect to the market for, or the price of, any securities.'

[20] (1981) 148 CLR 42.

been made of shares in a company at or about a particular level for the purpose of setting and maintaining a market price for those shares.'[21] The most recent support for this interpretation coming from Goldberg J in *ASIC v Soust* ('*Soust*'),[22] where his Honour concluded that the term 'artificial price',

> … connotes a price created not for the purpose of implementing or consummating a transaction between genuine parties wishing to buy and sell securities, but rather for a purpose unrelated to achieving the outcome of the interplay of genuine market forces of supply and demand.[23]

The decisions in *Soust*[24] represented the commonly accepted interpretation of 'artificial price' consistent with the decision in *North*, which had continued reasonably uninterrupted[25] until the decision in *JM (VSCA)*.

C *Procedural History*

The Defendant, JM, pleaded not guilty to all charges, however before the jury was empanelled Weinberg JA reserved three questions ('the original questions') to the Victorian Court of Appeal ('VSCA') under s 302 of the *Criminal Procedure Act 2009* (Vic).[26] The original questions were:

(1) … has [the share price] been created or maintained by a transaction … that was carried out for the sole or dominant purpose of creating or maintaining a particular price for that share on the ASX an "artificial price"?

(2) Was the closing price of shares in [X Ltd] on the ASX on 4 July 2006 an "artificial price"…?

(3) Was [share price] maintained at a level that was "artificial"…?

These questions were reformulated by Nettle and Hansen JJA (Warren CJ dissenting) in the VSCA[27] on the basis that it was inappropriate to decide any of the original questions[28] particularly as question one was a 'mixed question of fact and law dependent upon the assumed but as yet unfound fact of sole or dominant purpose.'[29] The case was remitted to Weinberg JA for amendment of the first question to read:

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[21] *North* (1981) 148 CLR 42, 59.
[22] (2010) 77 ACSR 98, [88]-[91]. See also *R v Chan* (2010) 79 ASCR 189.
[23] *Soust* (2010) 77 ACSR 98, [90].
[24] Later applied in *Chan* (2010) 79 ACSR 189, [22] (Forrest J).
[25] See for example: *Bond v ASIC* [2009] AATA 50, [36] (Deputy President Hack SC); *Soust* (2010) 77 ACSR 98, [88]-[91] (Goldberg J).
[26] *Director of Public Prosecutions v [Accused]* [2011] VSC 527 (restricted) (Ruling).
[27] *JM (VSCA)* (2012) 267 FLR 238.
[28] Ibid [303].
[29] Ibid.

(1) Is the expression "artificial price" in s 1041A used in the sense of a term having a legal signification (as opposed to its sense in ordinary English or some non-legal technical sense); and

(2) If so, what is its legal signification?[30]

The 'reformulated question' was then answered by the VSCA in the following way:

> [T]he expression "artificial price" in s 1041A of the *Corporations Act 2001* (Cth) is used in the sense of a term having legal signification (as opposed to its ordinary English or some non-legal technical sense); and that its legal signification is of market manipulation by conduct of the kind typified by American jurisprudential conceptions of "cornering" and "squeezing".[31]

The CDPP sought special leave to appeal the orders of the VSCA and the answer to the reformulated questions to the High Court. JM cross-appealed, alleging that the reformulated question was hypothetical and inappropriate for the VSCA to answer.

III THE DECISION OF THE HIGH COURT

In determining the issue as to the correct interpretation of s 1041 their Honours first examined the reasoning of the VSCA, followed by consideration of the *Cargill* decision before revisiting the decision in *North.*

A *Consideration of the Decision of the Majority in JM (VSCA)*

In *JM (VSCA)* their Honours focussed heavily on 'chain of statutory development'[32] and the similarities between the current 1041A and the previous s 10 of the *FIA 1986*. The VSCA held that, in light of this, it was relevant that the purposes of s 130 an 'artificial price' a price reflecting the market forces of supply and demand but one which is the result of a party with market dominance taking advantage of that dominance to exact a price different to that which would apply in times of adequate supply.[33] The Majority contrasted this view with that of Mason J in *North*, that an artificial price is a price which has been set or maintained at a level which does not reflect the forces of supply and demand in an open market (whether monopolistic or informed by pure competition).

The Majority did accept that it might be possible that the 'artificial price' in s 1041A might be used 'in a sense sufficiently protean to cover both

[30] Ibid [304].
[31] Ibid [369].
[32] Ibid [328].
[33] Ibid [334].

market manipulation of the kind typified by "cornering" and "squeezing" and also one or more of the kinds of false trading, market rigging and artificial setting and maintenance of prices.'[34] While the VSCA considered this a realistic possibility, they rejected this approach, taking the view that this was inconsistent with other provisions such as the more specific market misconduct provisions of the *Act*.[35]

The High Court rejected this construction of s 1041A on two grounds. First, Div 2 of Pt 7.10, read as a whole, does not require an interpretation of the provisions therein as operating in 'watertight compartments' without any scope for crossover between the provisions. This is supported by s 1041J which provides that the 'various sections in [Div 2] have effect independently of each other.'[36] Second, their Honours highlighted the limited application of s 1041A if the construction of the VSCA were accepted in respect of shares listed on the ASX. This is because, given the takeover provisions in Ch 6, it seems unlikely that a party would have the power to influence share prices in the sense of 'cornering' or 'squeezing' – which rely on a separation between the futures and commodities markets – whereas there is no separation of markets for shares as there is for commodities.[37] The Court accepted however, that there can be short-selling of shares where a seller may be vulnerable if the market moves in what for them is the wrong direction, which is analogous to a secondary market. However, even if s 1041A were restricted to this scenario there is nothing in the *Act* suggesting that the application of the section should be 'confined to circumstances in which the buyer or seller … has monopoly of, or dominant power over, the market for those shares.'[38]

B *The American Jurisprudence: Cargill*

The High Court then proceeded to consider the US decision of *Cargill*. The Court rejected the basis for consideration of *Cargill* in relation to the interpretation of s 1041A due to the limitation of that case to commodities and futures market as well as short selling.[39] Nevertheless, the Court did consider the broader principle arising from *Cargill,* which can be summarised in the following way:

> The aim [of the legislation under consideration in *Cargill*] must be therefore to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand.[40]

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[34] Ibid.
[35] Ibid.
[36] *JM* (2013) 298 ALR 615, [64].
[37] Ibid [65]-[66].
[38] Ibid.
[39] Which, as explained above would limit the utility of s 1041A of the *Act*.
[40] *Cargill* 452 F (2d) 1154 (1971), 1163.

The Court advanced that this was entirely consistent with the proposition in *North*, that the aim of the equivalent of s 1041A[41] is ensuring that the market reflects the forces of genuine supply and demand.'[42]

C *A Sole or Dominant Purpose Inconsistent with the Market Forces of Genuine Supply and Demand*

Having outlined the broad construction of s 1041A, their Honours explained the meaning of 'genuine supply and demand'. To that end, their Honours borrowed heavily for their definition of the concept from the decision of Mason J in *North.* Mason explained the concept as:

> Transactions which are real and genuine but only in the sense that they are intended to operate according to their terms, like fictitious or colourable transactions, are capable of creating quite a false or misleading impression as to the market or the price. This is because they would not have been entered into but for the object on the part of the buyer or of the seller of setting and maintaining the price, yet in the absence of revelation of their true character they are seen as transactions reflecting genuine supply and demand and having as such an impact on the market.[43]

In light of this starting point their Honours explained that, the reference to an artificial price in s 1041A should be construed as catching transactions 'where the on-market buyer or seller of listed shares undertook it for the sole or dominant purpose of setting or maintaining the price at a particular level.'[44]

The Court went on to explain that even where an 'artificial price' is not created or maintained, the scope of s 1041A is such that transactions which are 'likely to have' the effect of creating or maintaining an 'artificial price' will still be captured by the provision.[45] Therefore there is no need to demonstrate by counterfactual analysis that the impugned transaction did in fact create or maintain an artificial price;[46] all that need

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[41] *Securities Industry Act 1970* (NSW) s 70.
[42] *North* (1981) 148 CLR 42, 59.
[43] Ibid.
[44] *JM* (2013) 298 ALR 615, [71]. However, the Court did recognise that there may be other kinds of transaction which fall within this definition, though this was outside the scope of the case and was not decided upon. Their Honours cited Emilios E. Avgouleas, *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis* (Oxford University Press, 2005) 131-154. See also below n 51.
[45] *Corporations Act 2001* (Cth) s 1041A(a) and (b).
[46] *JM* (2013) 298 ALR 615, [73]. A counterfactual analysis is essentially an analysis of the possible outcome (in this case the share price) with or without the conduct in question. See for example (in the context of the *Australian Competition and Consumer Act 2010* (Cth) s 50) *Australian Competition and Consumer Commission (ACCC) v Metcash Trading Limited* [2011] FCA 967 [145] (Emmet J); *Australian Competition and Consumer Commission (ACCC) v Metcash Trading Ltd* [2011] FCAFC 151, [25], [27], [32], [89] (Buchannan J).

be proved is a sole or dominant purpose to create or maintain such a price. And to this end, it is also not necessary to show that the impugned transaction(s) 'went on to affect the behaviour of genuine buyers and sellers in the market'[47] – rejecting the dissenting judgment of Warren CJ in the VSCA on this point.

Finally, and for completion, with it not being argued by JM, the High Court explained that it is immaterial whether the impugned transaction has the 'sole' or 'dominant' purpose of creating or maintaining an artificial price.[48] However, the Court did not go as far as stating that proof of a 'sole' or 'dominant' purpose of setting or maintaining an artificial price would be the only way s 1041A might be breached, rather limiting the decision to the facts of the case, the Court held only that s 1041A would be breached where such proof existed.

D *The Decision of the High Court*

The ultimate decision of the High Court was to allow the appeal of the CDPP and allow in part JM's cross-appeal, remitting the original questions to Weinberg JA, answering 'yes' to all of them.

IV THE CONSEQUENCES OF THE HIGH COURT'S BROAD INTERPRETATION OF S 1041A

The decision of the High Court in *JM* is important because it restores the broad interpretation of 'artificial price', which, having its genesis in the decision of Mason J in *North* had persisted through to the decisions in *Soust* and *Chan.* However, one of the most significant features of the case arises more from what is not said in the case rather that what was actually decided. *JM* is in many ways a restricted judgment and while the importance of clarifying the interpretation of s 1041A cannot be understated, the Court did not elaborate on the implications for transactions which would prima facie fall within the broadened definition of 'artificial price'. Specifically, market stabilisation activities associated with initial public offers ('IPOs') are a perfect example or a transaction which may fall foul of s 1041A while not necessarily conflicting with the objective of the market misconduct provisions in 'ensuring adequate levels of consumer protection and market integrity'[49]

A *Market Stabilisation*

The High Court alluded to the possibility of transactions other than those in context of *JM* 'which have the effect of creating or maintaining an

[47] *JM (VSCA)* (2012) 267 FLR 238, [260].
[48] *JM* (2013) 298 ALR 615, [75].
[49] Explanatory Memorandum, *Financial Services Reform Bill 2001*,[1.5].

artificial price in a market for listed shares',[50] however this was not expanded upon. However, it is likely that the court was to some extent accepting that transactions falling within their Honour's broad interpretation of s 1041A could serve a legitimate role within the market. This is because their Honours cited Avgouleas who argues for, *inter alia*, the legitimacy of market stabilisations activities – which are expressly permitted in the UK, US and Hong Kong.[51]

The reason market or price stabilisiation[52] activities are permitted in these jurisidictions is that they aim to affect an orderly secondary market for shares following an IPO, thereby serving a legitimate role in curtailing fluctuations in share prices following an IPO.[53] Additionally, market stabilisation improves investor confidence by signalling to investors that the sudden influx of shares will not mean the prices of shares are artificially deflated.[54]

B *No-Action Letters*

In 2005, ASIC released a consultation paper[55] indicating that in some circumstances they would issue a no-action letter in the circumstances of transparent market stabilisation activities carried out by an issuer or underwriter within 30 days of a new share float.[56] A no-action letter will only state that ASIC does not intend to take action against those involved in the transactions where ASIC is 'of the clear view that it would not advance the policy of the legislation to take enforcement action on that conduct.'[57] However, this does not restrict others who may be aggrieved by the stabilisation activities seeking to avoid liability by challenging the transactions on the basis of illegality, as in *North*.[58] Therefore, brokers

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[50] *JM* (2013) 298 ALR 615, [71].

[51] Avgouleas, above n 44, 141. Trade-based manipulations would include market stabiliastion activities associated with initial public offers – which are legal in the UK and the US. Avgouleas explains, 'the underlying rationale [for which] is that on the eve of a new issue, speculators may try to depress the market price of the security. If the issue pertains to convertible securities, it is not unusual for the syndicate to 'stabilize' not only the price of the security concerned, but also that of the underlying security – so-called share 'ramping'. In this sense, stabilization in certain cases amounts to legal, albeit serious, adulteration of the market's price formation mechanism.'

[52] The terms may be used interchangeably, see: Anton Trichardt 'Australian Green Shoes, Price Stabilisation and IPOs: Part 1' (2003) 21 *Companies and Securities Law Journal* 26, 33.

[53] See Avgouleas, above n 44, 141.

[54] ASIC, above n 8, [2].

[55] Ibid.

[56] Avgouleas, above n 44, [4]. See: Anton Trichardt 'Australian Green Shoes, Price Stabilisation and IPOs: Part 1' (2003) 21 *Companies and Securities Law Journal* 70; Butterworths, above n 18, [7.13.0045].

[57] ASIC, above n 8, [4].

[58] In *North* (1981) 148 CLR 42 the integrity of the contract for remunerations between the client and the brokers was successfully challenged on the basis that the contract was tainted

and underwriters in Australia are in the untenable position whereby they may be engaging in activities that, although not necessarily in conflict with the objectives of the market misconduct provisions of the *Act*, may nevertheless the open to legal challenge. This therefore leads unjustifiable uncertainty of the kind that does not exist in the other advanced economies.[59]

V CONCLUSION

The decision in *JM* represents an important clarification of the scope of s 1041A. It restores the broad interpretation of what constitutes an artificial price for the purposes of s 1041A and previous versions of the provisions, as well as reiterating the independent operation of the provisions within Div 2 of Pt 7.10 of the *Act*.[60] The decision also clarifies the requirement for a sole or dominant purpose to create such a price, while leaving room for a purpose which falls below this level to be caught by s 1041A. However, the impact of this broad interpretation on activities which are not contrary to the objectives of the market misconduct provisions, such as market stabilisation, is not sufficiently explored so as to provide certainty for brokers and underwriters who routinely engage in this conduct – albeit with the limited protection of ASIC in the form of no-action letters. These transactions remain open to challenge on the basis of illegality and therefore certainty in Australia's capital markets is arguably less than it should be.

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with illegality by virtue of contraventions of s 70 of the *Securities Industry Act 1970* (NSW):
Ann O'Connell, 'Protecting the Integrity of Securities Markets – What is an "Artificial Price"?: *DPP (Cth) v JM*' on *Opinions on High* (1 August 2013) <http://blogs.unimelb.edu.au/opinionsonhigh/2013/07/25/o-connell-jm/>.

[59] See above n 10.

[60] *JM* (2013) 298 ALR 615, [64] – largely in reliance on s 1041J of the *Act*.