An Analysis of Market Manipulation under the Securities Services Act 36 of 2004 (Part 2)*

REHANA CASSIM**
University of the Witwatersrand

4.3 False, Misleading or Deceptive Statements, Promises and Forecasts

Section 76(1) of the SSA prohibits disclosure-based market manipulation as follows:

> '76 (1) No person may, directly or indirectly, make or publish in respect of listed securities, or in respect of the past or future performance of a public company –
> *(a)* any statement, promise or forecast which is, at the time and in the light of the circumstances in which it is made, false or misleading or deceptive in respect of any material fact and which the person knows, or ought reasonably to know, is false, misleading or deceptive; or
> *(b)* any statement, promise or forecast which is, by reason of the omission of a material fact, rendered false, misleading or deceptive and which the person knows, or ought reasonably to know, is rendered false, misleading or deceptive by reason of the omission of that fact.'

As discussed, disclosure-based market manipulation entails the dissemination of inaccurate information relating to the demand, supply, price or value of a security. Spreading false rumours has been said to be one of the most common manipulative devices in this regard.[167]

The difference between disclosure-based market manipulation and insider trading is that insider trading entails a person dealing in securities on the basis of price-sensitive confidential information which, if publicly known, would affect the price of the security in question, while disclosure-based market manipulation entails a person making or publishing false or misleading information to the market which materially affects the price of securities.[168] The difference lies in whether the information concerned is accurate or misleading and in the use to which the information is put.[169]

A common manipulative scheme involving disclosure-based manipulation is known as the 'hype-and-dump' or 'pump-and-dump' scheme.[170] This involves the touting of a company's shares through deceptive statements, with the object of inducing unwary investors to buy shares in the company in order to drive the price of the shares higher. After the price is 'pumped up' by all the hype, a buying frenzy is created and as the demand for the shares increases, its price inevitably rises. After pumping up the shares, the manipulators then 'dump' their shares on the market, making a handsome profit for themselves.

---

* Continued from (2008) 20 *SA Merc LJ* 33.

** BA LLB LLM (Witwatersrand). Lecturer, School of Law, University of the Witwatersrand, Johannesburg. Attorney and Notary Public of the High Court of South Africa.

[167] *Cargill v Hardin* 452 F 2d 1154 (8th Cir, 1971) at 1163.

[168] See NZ Ministry of Economic Development op cit note 3 in par 13.

[169] Ibid.

[170] Idem in par 66.

Cite as: (2008) 20 *SA Merc LJ* 177–199.

Once they have done this, they immediately stop pumping the shares, the price falls in consequence, and the deceived investors lose their money.[171]

4.3.1 The Scope of s 76 of the SSA

A distinguishing feature of s 76(1) of the SSA, compared to the equivalent sections in the Financial Services and Markets Act, 2000,[172] the EU Market Abuse Directive,[173] and the Securities Exchange Act of 1934,[174] is that it not only prohibits the making or publishing of false statements in respect of listed securities, but it in addition prohibits such statements being made in respect of the past or future performance of a public company. This is commendable since it is quite conceivable that a misleading statement made about the past or future performance of a public company, be it a positive or negative statement, could have the effect of increasing, maintaining or reducing the price of the securities of that company. In this respect s 76(1) is clearly wider than the equivalent sections in leading foreign jurisdictions.

4.3.2 'Directly or indirectly'

Like s 75(1)(*a*), s 76(1) prohibits directly or indirectly, the making or publishing of false, misleading or deceptive statements, promises or forecasts. But, unlike s 75(1)(*a*), s 76(1) does not prohibit a person from knowingly participating in the making of a false, misleading or deceptive statement, promise or forecast. On the interpretation of the words 'directly or indirectly' advocated in *Central Bank of Denver v First Interstate Bank of Denver*,[175] these words do not extend to secondary actors who do not directly engage in making the false statement but who simply aided and abetted another in making the false statement, such as editing a false statement issued by a client to the public. On this basis, the threshold required for a secondary actor's conduct to implicate primary liability would be the more popular bright line test,[176] under which a secondary actor would be liable only if he or she actually made the false statement, or the substantial participation test,[177] in terms of which a secondary actor would be liable if he or she substantially

[171] See Ali op cit note 6 at 222.

[172] Section 118(7) of which prohibits the dissemination of information which gives a false or misleading impression as to a qualifying investment.

[173] Article 1(2)(*c*) of which prohibits the dissemination of information, through the media, including the Internet, or by any other means, which gives or is likely to give false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news, where the person who made the dissemination knew or ought to have known, that the information was false or misleading.

[174] Rule 10*b*-5 of which prohibits the making of untrue statements or the omission of material facts, in connection with the purchase or sale of any security, while §9(*a*)(4) of the Securities Exchange Act of 1934 applies to a dealer or broker or a person selling or offering for sale or purchasing or offering to purchase a security, and makes it unlawful for such persons to make, 'for the purpose of inducing the purchase or sale' of a security, any 'statement, which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.'

[175] Supra note 12, and see the discussion in par 4.1.3 above.

[176] Discussed in par 4.1.3 above.

[177] Discussed in par 4.1.3 above.

participated in the practice in question. It is not clear whether the interpretation of the words 'directly or indirectly' in *Central Bank of Denver* is to be applied to s 76(1). For reasons of consistency with s 75, it is submitted that the interpretation of the words 'directly or indirectly' in *Central Bank of Denver* ought to be rejected and that if a secondary actor substantially participates in making a false statement under s 76(1), he or she ought to be regarded as having contravened the section.

4.3.3 Assessment of the Statement, Promise or Forecast

According to s 76(1) of the SSA, the statement, promise or forecast is assessed at 'the time and in the light of the circumstances in which it is made.' There may well be cases where, with the benefit of hindsight, a statement, promise or forecast that was previously acceptable could subsequently be regarded as constituting market manipulation. If the statement, promise or forecast were acceptable at the time it was made, then the accused person will not be regarded as having engaged in market manipulation at that time, but the same behaviour at a later stage may well be regarded as constituting market manipulation.[178]

4.3.4 Inducement to Buy or Sell Listed Securities

It is significant that it is no longer a pre-requisite to constituting an offence under s 76 of the SSA that a third party must have been *induced* to buy or sell listed securities by the false, misleading or deceptive statement. The mere making of the false, misleading or deceptive statement, promise or forecast constitutes an offence. Whether a statement is likely to induce the sale or purchase of securities is an objective question, and depends on the likely effect of the statement on the market for the securities.[179] If proof of motive is required in order to prove manipulative conduct, it becomes much more difficult to prove the offence, as it is usually very difficult to ascertain with certainty what motivates a particular statement.[180]

In contrast, s 40(1)(*a*) of the Stock Exchanges Control Act of 1985 prohibited a person from inducing any other person to buy or sell listed securities by means of a statement, promise, forecast or any other action which he knew to be misleading or which was likely to be misleading. In a similar vein s 21 of the Financial Markets Control Act of 1989 prohibited the making of false or misleading statements which were likely to induce other persons to deal in financial instruments on a financial market, and s 22 of that Act prohibited a person from fraudulently inducing another to deal in financial instruments. Clearly 76(1) of the SSA has significantly tightened up the offence since the motive for making the false or misleading statement is now irrelevant. Significantly, the requirement of proving the purpose of the

[178] See Alexander op cit note 157.
[179] See Black op cit note 27 at 1002.
[180] See NZ Ministry of Economic Development op cit note 3 in pars 43 and 130.

statement continues to apply to §9(*a*)(4) of the Securities Exchange Act of 1934[181] and to ss 1041E[182] and 1041F[183] of the Australian Corporations Act of 2001.

4.3.5 Omission of Material Facts

Section s 76(1) of the SSA prohibits not only the making of false, misleading or deceptive statements, promises or forecasts, but also the omission or concealment of a material fact that renders a statement, promise or forecast false, misleading or deceptive. In this respect it is much more stringent than the equivalent offence in the Stock Exchanges Control Act of 1985 and in some leading foreign jurisdictions.[184]

Save for rule 10*b*-5 of the Securities Exchange Act of 1934 which makes it an offence to omit to state a material fact necessary to make a statement made in connection with the purchase or sale of a security not misleading, neither the Financial Services and Markets Act, 2000[185] nor the EU Market Abuse Directive[186] go so far as to prohibit the concealment of material facts that render information false or misleading. Likewise, s 1041E of the Australian Corporations Act of 2001, which prohibits the making of false or misleading statements, does not explicitly make the concealment of a material fact an offence, but its s 1041F, which makes it an offence to induce persons to deal in financial products, does make it an offence to induce a person to deal in financial products by a dishonest concealment of material facts.[187]

4.3.6 Material Facts

In order for s 76(1)(*a*) of the SSA to apply, the statement in question must be false, misleading or deceptive in respect of a *material fact*, or must be rendered false, misleading or deceptive by reason of the omission of such a fact. Materiality was not required by s 40(1)(*a*) of the Stock Exchanges Control Act of 1985 or by s 21 of the Financial Markets Control Act of 1989, but s 22 of the latter Act did prohibit the fraudulent inducement of a person to deal in financial instruments by the concealment of material information.

---

[181] See note 174 where this section is discussed. But rule 10*b*-5(*b*) of the Securities Exchange Act of 1934 does not require the purpose of the statement to be proved.

[182] Which prohibits the making of false or misleading statements or information if the statement or information is likely to induce persons to apply for, dispose of or acquire financial products.

[183] Which makes it an offence to induce another person to deal in financial products by making or publishing a statement, promise or forecast if the person knows or is reckless as to whether the statement is misleading, false or deceptive, or by a dishonest concealment of material facts or by recording or storing information that the person knows to be false or misleading in a material particular or to be materially misleading.

[184] Section 40(1)(*a*) of the Stock Exchanges Control Act of 1985 did not prohibit the concealment of information, but s 22(*b*) of the Financial Markets Control Act of 1989 prohibited the concealment of material information with the purpose of inducing another person to deal in a financial instrument on a financial market.

[185] See its s 118(7).

[186] Its art 1(2)(*c*) and the discussion in note 173 above.

[187] See the discussion in note 183 above. 'Dishonest' is defined in s 1041F(2) as meaning dishonest according to the standards of ordinary people and known by the person to be dishonest according to the standards of ordinary people.

Disappointingly, the SSA has failed to provide any guidance as to when a fact, or an omitted fact, would be material.

The role of the materiality requirement is to filter out essentially useless information that a reasonable investor would not consider significant.[188] In *TSC Industries, Inc v Northway, Inc*,[189] the Court rejected a formulation of the test of materiality used by the lower courts in America that material facts include 'all facts which a reasonable shareholder *might* consider important' on the ground that it sets too low a threshold for the imposition of liability.[190] The Court emphasised that if too low a standard of materiality were set, it could result in a company and its management being subjected to liability for insignificant omissions or misstatements, and management's fear of exposing itself to substantial liability would cause it 'simply to bury the shareholders in an avalanche of trivial information – a result that is hardly conducive to informed decisionmaking.'[191] In respect of an omitted fact the test was formulated as follows: 'An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.'[192]

According to this test, materiality depends on the significance which a reasonable investor would place on the misrepresented or withheld information.[193] It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused a reasonable shareholder to change his vote, but contemplates a showing of a substantial likelihood that under all the circumstances the omitted fact would have assumed actual significance in the decision of the shareholder.[194] This shows that materiality is an objective question and that it is a mixed question of fact and law.[195] It is submitted that in the context of s 76 of the SSA, the test for the materiality of a statement, promise or forecast ought not to be too lenient and perhaps the test for the materiality of an omitted fact as adopted in *TSC Industries v Northway* should be applied to s 76(1) too.

4.3.7 Fault

A common feature of the prohibition against making a false or misleading statement contained in s 76(1)(*a*) of the SSA, the Securities Exchange Act of

---

[188] *Basic Inc v Levinson* supra note 89 at 234.

[189] 426 US 438 (US SC,1976) set out a test for the materiality of an omitted fact in the context of rule 14*a*-9, 17 CFR §240.14*a*-9 ('rule 14*a*-9'), promulgated under §14(*a*) of the Securities Exchange Act of 1934. Rule 14*a*-9 prohibits the making of any proxy statement, form of proxy, notice of meeting or other communication containing any statement which, in light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading. *Basic Inc v Levinson* supra note 89 adopted the test of materiality set out in *TSC Industries v Northway* and extended the application of the §14(*a*) definition of materiality to rule 10*b*-5 of the Securities Exchange Act of 1934: see *Basic Inc v Levinson* at 232n8.

[190] *TSC Industries, Inc v Northway, Inc* supra note 189 at 449.

[191] At 448-9.

[192] At 449.

[193] *Basic Inc v Levinson* supra note 89 at 240.

[194] *TSC Industries, Inc v Northway, Inc* supra note 189 at 449.

[195] At 445 and 450.

1934,[196] the Australian Corporations Act of 2001,[197] the Financial Services and Markets Act, 2000,[198] and the EU Market Abuse Directive,[199] is that they all prohibit the making of such statements in circumstances where the person making the statement knows, or ought reasonably to know, that the statement is false or misleading. To put it differently, the offence is committed where the fault element is either intention or negligence. Under s 40(1)(*a*) of the Stock Exchanges Control Act of 1985, which prohibited the making of a misleading statement, negligence was not sufficient in this context and proof of intention was required.[200] This again is a reflection of the tightening up of the offence in the SSA.

4.3.8 'Make or publish'

Developments in technology, most notably the Internet, have considerably increased the potential for disclosure-based market manipulation as they have changed the ways in which information can be or is disseminated.[201] The Internet provides market manipulators with ready access to on-line newsletters, bulletin boards, chat rooms and e-mail, all of which provide a much greater opportunity for market manipulation.[202] Statements posted on the Internet may range from mere opinions to subjective predictions and other unsubstantiated rumours, which could even be purported to have been confirmed by the company, to deliberately fabricated lies.[203] The price of a security may be influenced within minutes of posting information on a newsgroup or discussion forum.[204] Of greater concern, as pointed out by the EU Market Abuse Directive, is the fact that the Internet has the effect of increasing cross-border activities.[205]

For these reasons it is imperative that the publication and the dissemination of false information on the Internet be stringently regulated in South Africa. While s 76(1) of the SSA does not specifically prohibit the dissemination of information on the Internet, it is arguable that the word 'publish' in s 76(1) would include publication on the Internet. In contrast, art 1(2)(*c*) of the EU Market Abuse Directive explicitly prohibits the dissemination of information on the Internet, which is the preferable approach in view of the enormity of the problem.

---

[196] See §9(*a*)(4) of the Securities Exchange Act of 1934 and the discussion in note 174 above.

[197] In its s 1041E(1)(*c*)(*ii*).

[198] In its s 118(7).

[199] In its art 1(2)(*c*), and see the discussion in note 173 above.

[200] This is indicated by the use of the words 'which he or she knows to be misleading' in s 40(1)(a) of the Stock Exchanges Control Act of 1985. However, under s 21 of the Financial Markets Control Act of 1989, negligence was sufficient for the offence of making a false or misleading statement to be committed.

[201] See the NZ Ministry of Economic Development op cit note 3 in par 68.

[202] For example, an imposter can alter or falsify e-mails (known as 'spoofing') and can in this way manipulate the price of securities: see Toross op cit note 151 at 1417 and 1419.

[203] The most common practice involves posting several messages on the Internet in rapid succession, which all repeat the same 'prediction': idem at 1428.

[204] Idem at 1403.

[205] See Recital 10 to the EU Market Abuse Directive.

In America, the Securities and Exchange Commission has established a unit, known as the Office of Internet Enforcement, to combat the large number of securities violations perpetrated on the Internet.[206] The Office has been tasked with developing policies and procedures for Internet surveillance, managing e-mail complaints and providing guidance for the conduct of Internet-fraud investigations.[207] It is especially difficult to combat market manipulation on the Internet as the market manipulators are usually anonymous.[208] Some of the methods used by the Securities and Exchange Commission to address market manipulation on the Internet are that it has improved the surveillance of the Internet by specifically training and assigning staff members to monitor the Internet; it has embraced self-policing by encouraging Internet users to report suspicious postings to a complaint centre established specifically for this purpose; and it regularly publishes information designed to educate Internet investors on market manipulation via the Internet.[209] As emphasised by the Securities and Exchange Commission, the prevention of market manipulation through investor education is often more effective than after-the-fact remedies aimed at minimizing investor losses.[210]

It is submitted that we must not lag behind other jurisdictions and must enhance our policies and procedures to identify and deter market manipulation on the Internet in order to provide more effective protection for the market and its investors. In particular, more focus must be placed on educating Internet investors on market manipulation via the Internet, as has been done in America.

5 Defences

Apart from a price-stabilisation defence, s 75 of the SSA does not make provision for any other defence to market manipulation; s 76 does not make provision for any defence at all. It is submitted that it is possible for a definitional defence to be raised under ss 75 and 76 of the SSA. More about this shortly. In contrast, leading foreign jurisdictions make specific provision for a number of defences to market manipulation, in addition to a price-stabilisation defence. These defences are also canvassed below.

---

[206] See Toross op cit note 151 at 1417.

[207] Idem at 1440.

[208] Anonymizing tools may be employed to delete the identifying information from message headers (which are the electronic equivalent of envelopers) and thus defeat the possibility of tracing a message to its point of origin: idem at 1418.

[209] See the US Securities and Exchange Commission Report to the Congress *The Impact of Recent Technological Advances on the Securities Market* (1997), available at *http://www.sec.gov/news/studies/techrp97.htm* (last consulted on 17 Mar 2008).

[210] Ibid.

5.1 Price-stabilisation

Section 75(3) of the SSA provides as follows:

> '[T]he employment of price-stabilising mechanisms that are regulated in terms of the rules or listing requirements of an exchange does not constitute a manipulative, improper, false or deceptive trading practice for the purposes of this section . . . .'

A price-stabilisation defence has been provided for in Chapter 5 of the JSE Listings Requirements. Rule 5.99 of these Requirements states quite clearly that its purpose is to define the

> 'circumstances and manner in which price stabilisation will be permitted by the JSE, in accordance with the provisions of Stock Exchanges Control Act of 1985 [now the SSA] and as a defence against the offences of manipulative, false or improper trading practices, as stipulated in Stock Exchanges Control Act of 1985 [now the SSA]'.

Price-stabilisation involves trading in a security at the time of an offer of securities in order to prevent or retard a decline in the market price of the security.[211] It usually involves trading by issuers, underwriters or those participating in the offer of securities in order to prevent the offer failing.[212] The stabilisation may be used only to prevent or slow down a decline in the price of securities, but not to raise the price.[213] Price-stabilisation is sometimes necessary since an offer of securities may lead to a fall in the price of the securities due to the sudden increase in supply or to imperfections in the pricing and allocation process.[214] To counteract the effect of this artificially low price, the underwriter of an offer, for instance, may endeavour to stabilise the price of the securities by purchasing the securities, or offering to purchase them, for a limited period after their issue or sale.[215] The main purpose of price-stabilising mechanisms is thus to promote an orderly secondary market following an offer of shares.[216] These mechanisms are legitimate as they help to promote investor confidence in the market for a new issue of shares, and the general opinion is that this enhanced confidence is beneficial to the market.[217] Price-stabilisation mechanisms would also assist corporate fundraising since companies would be more inclined to raise funds in this way if they have the assurance of knowing that there would be some kind of initial support for the price of the securities.[218]

Chapter 5 of the JSE Listings Requirements sets out the requirements that must be complied with before embarking on price-stabilisation. The most

---

[211] See NZ Ministry of Economic Development op cit note 3 in par 76.

[212] Ibid.

[213] See the New Zealand Ministry of Economic Development *Securities Legislation Bill Regulations: Discussion Document* (2006), available at *http://www.med.govt.nz/upload/32930/bill-regs-disc.pdf* (last consulted on 17 Mar 2008) in par 148.

[214] Idem in par 141.

[215] Ibid.

[216] Rule 5.99 of the JSE Listings Requirements. See also Recital 11 to Commission Regulation (EC) 2273/2003 of 22 Dec 2003, implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programs and stabilisation of financial instruments (*Official J* L336 of 23 Dec 2003) (the 'EU Market Abuse Regulations').

[217] Recital 11 to the EU Market Abuse Regulations; NZ Ministry of Economic Development op cit note 213 in par 143.

[218] See NZ Ministry of Economic Development op cit note 213 in par 143.

important requirement is that adequate disclosure must have been made in all communications issued by or on behalf of the issuer or the stabilising manager[219] to prospective investors in the securities that stabilisation may take place in relation to the relevant offer.[220] While stabilisation creates the impression that there is a demand for the securities at a particular price, and while it may artificially affect the share price or create a false or misleading appearance with respect to trading in the offered shares, it would not be manipulative if it were disclosed to the public since investors would have been forewarned that stabilisation may occur.[221] A further important requirement is that the stabilisation may take place only during the stabilisation period, which is limited to a maximum of 30 calendar days.[222] Stabilisation may be effected through an over-allotment,[223] which may not be more than fifteen per cent of the issue size,[224] with or without a 'greenshoe'.[225] A greenshoe is an option or other right which is granted for a specified period of time. It is exercisable by the stabilising manager in order to acquire up to a specified number of securities in addition to the initial issue number, so that it is able to honour the commitments made during the stabilisation period.[226]

Price-stabilisation is permitted under American,[227] European Union,[228] United Kingdom,[229] and Australian[230] law in certain prescribed circumstances.

---

[219] The stabilising manager is the entity responsible for the stabilising action. In terms of rule 5.118 of the JSE Listings Requirements, the stabilising manager must be a member of the JSE, the Life Offices' Association of South Africa, the Council of South African Banks, the Merchant Bankers' Association, the Bond Exchange of South Africa, or a person (natural or juristic) in South Africa or elsewhere in good standing and acceptable to the JSE. The stabilising manager must also satisfy the JSE that it has net tangible assets of not less than R2b in jurisdictions acceptable to the JSE, and must undertake that throughout the stabilisation period it will maintain at least R2b of its assets in these jurisdictions: rule 5.118(*d*) of the JSE Listings Requirements.

[220] See rules 5.104(*a*) and 5.110 of the JSE Listings Requirements.

[221] See Practical Law Company Practice Note op cit note 128 at 35; How Chih Lee 'Market Manipulation in the US and UK: Part 2' (1993) 14 *The Company Lawyer* 123 at 126; Australian Securities and Investments Commission ('ASIC') Consultation Paper 63 *Market Stabilisation* (Mar 2005), available at *http://www.asic.gov/au/asic/pdflib.nsf/LookupByFileName/PPP_market_stabilisation.pdf/$file/PPP_market_stabilisation.pdf* (last consulted on 17 Mar 2008) at 22.

[222] See rules 5.104 and 5.105 of the JSE Listings Requirements.

[223] An over-allotment is the allotment of shares in excess of the number of shares to be issued or sold in the offer: rule 5.100 of the JSE Listings Requirements.

[224] Rule 5.109 of the JSE Listings Requirements.

[225] Rule 5.99(*a*) of the JSE Listings Requirements.

[226] Rule 5.100 of the JSE Listings Requirements.

[227] Rule 104(*b*) of Regulation M under the Securities and Exchange Act (17 CFR §242.104) permits stabilisation mechanisms for the purpose of preventing or retarding a decline in the market price of a security in order to facilitate an offering, provided that the requirements of the regulation are met. Regulation M was adopted by the SEC in Dec 1996: see SEC Exchange Act Release No 38067, 20 Dec 1996, published in 62 Fed Reg 520, 3 Jan 1997 (available at *www.sec.gov/rules/final/34-38067.txt*), which became effective on 4 Apr 1997.

[228] The EU Market Abuse Regulations contains detailed rules regulating price stabilisation.

[229] Section 118(5)(*b*) of the Financial Services and Markets Act, 2000, provides that behaviour does not amount to market abuse for the purposes of the Act if it conforms with the relevant provisions of the EU Market Abuse Regulations. MAR 2 also contains detailed rules regulating price-stabilisation.

[230] The Australian Securities and Investments Commission allows price-stabilisation arrangements in limited circumstances and under defined conditions. For instance, the Commission is able to issue 'no-action' letters in which it states to a particular person that it does not intend to take action where that

5.2 Definitional Defences

A definitional defence is one that goes to the question of whether there was market manipulation in the first place.[231] For instance, a person accused of knowingly participating in a manipulative trading practice under s 75(1)(*a*) of the SSA may raise a defence that he or she did not knowingly participate in the trading practice, that is, that he or she lacked the intention to participate in the trading practice; or a person accused of market manipulation under s 76(1) of the SSA may raise the defence that he or she did not know or could not reasonably have known that the statement published was misleading in respect of a material fact. These are merely instances of definitional defences which, it is submitted, may be raised to a charge of market manipulation under ss 75 and 76.

5.3 Share Buy-back Programmes

Directors of a company who undertake a share buy-back with the intention of affecting the market price of the shares, would be guilty of market manipulation.[232] The possibility of market manipulation is commonly regarded as a serious consequence of recognising the right of a company to buy back its own shares.[233] However in America,[234] the European Union,[235] and the United Kingdom,[236] if a company buys back its own shares in compliance with certain requirements, the share buy-back would not constitute market manipulation. This defence has been permitted for economic reasons, for instance, the share buy-back could be used to strengthen the equity capital of issuers which would clearly be in the interests of investors.[237]

---

person has undertaken price-stabilisation arrangements in line with its stated conditions: see ASIC Consultation Paper 63 op cit note 221 at 6.

[231] See Jonathan Herbst & Katie McCaw 'Statutory Exceptions and Defences: What Protection is Available?' (2001) 22 *The Company Lawyer* 206 at 211.

[232] See HAJ Ford, RP Austin & IM Ramsay *Ford's Principles of Corporations Law* 13 ed (2007) in par 24.470 at 1303.

[233] See MS Blackman, RD Jooste & GK Everingham *Commentary on the Companies Act* vol 1 (2002) at 5.56. See also the UK Consultative Document *The Purchase by a Company of Its Own Shares* (Cmnd 7944) (1980) (popularly known as 'Gower's Consultative Green Paper') in par 11 at 9-10, where Gower points out that allowing companies to buy their own shares may lead to market-rigging. A similar objection is made by Adolf A Berle & Gardiner C Means *The Modern Corporation and Private Property* (rev ed, 1967) at 159-60. The possibility of insider trading is also commonly regarded as a serious consequence of recognising the right of a company to buy back its own shares. In this regard it has been argued that all companies, whether or not their shares are listed on the stock exchange, ought to be declared 'insiders' for the purposes of the prohibition against insider trading so as to compensate a seller of shares who suffers loss by selling his shares to the company as a result of the company's use of confidential information which is not publicly known: see FHI Cassim 'The New Statutory Provisions on Company Share Repurchases: A Critical Anaylsis' (1999) 116 *SALJ* 760 at 777. This would not apply to unlisted securities as these do not fall within the scope of the SSA, but it could be of relevance to the common law liability of insider trading: see Cassim op cit note 11 at 55.

[234] See rule 10*b*-18 of the Securities Exchange Act of 1934 (purchases of certain equity securities by the issuer and others).

[235] See art 8 of the EU Market Abuse Directive and art 3 of the EU Market Abuse Regulations.

[236] See s 118A(5)(*b*) of the Financial Services and Markets Act, 2000.

[237] See Recital 33 to the EU Market Abuse Directive.

Under the EU Market Abuse Directive and the Financial Services and Markets Act, 2000, the share buy-back defence applies where the sole purpose of the buy-back programme is to reduce the capital of an issuer (in value or in number of shares), or to meet obligations arising from debt-financial instruments exchangeable into equity instruments or from allocations of shares to employees under employee share schemes.[238] The most important requirements that must be complied with in order for the share buy-back defence to be successfully relied on as a defence, are that full details of the share buy-back programme have to be publicly disclosed; that the issuer must have in place the mechanisms to ensure that it fulfils trade-reporting obligations to the relevant authority; that the issuer must publicly disclose all transactions; and that, except in limited circumstances, the issuer must not, during its participation in the share buy-back programme, sell its own shares or deal during a closed period[239] or when it is in possession of undisclosed inside information.[240] In relation to the price, when executing trades under a share buy-back programme, the issuer may not purchase shares at a price higher than the higher of the price of the last independent trade and the highest current independent bid on the trading venues where the purchase is carried out.[241] In order to prevent market manipulation, the daily volume of trading in own shares in a share buy-back programme is limited: the issuer may not purchase more than 25 per cent of the average daily volume of the shares in any one day on the regulated market on which the purchase is carried out.[242] Similar conditions relating to the manner, timing, price and volume of the share buy-back apply also to the share buy-back defence contained in rule 10*b*-18 of the Securities Exchange Act of 1934.

5.4 Legitimate Reasons and in Conformity with Accepted Market Practices

Like s 75(1) of the SSA, art 1(2)(*a*) of the EU Market Abuse Directive prohibits transactions or orders to trade which give, or are likely to give, false or misleading signals as to the supply of or demand for or price of financial instruments, or which secure the price of a financial instrument at an abnormal or artificial level. But, unlike s 75(1), a person accused of such an offence under art 1(2)(*a*) may raise the defence that his or her reasons for entering the

[238] See art 3 of the EU Market Abuse Regulations; s 118A(5)(*b*) of the Financial Services and Markets Act, 2000; MAR 1 Annex 1 Provisions of the Buy-back and Stabilisation Regulation relating to Buy-back Programmes (the 'Buy-back Regulation') in MAR 1.1.3.

[239] A 'closed period' is the period during which purchases or early redemptions by a company of its own securities may not be made: see MAR 1.1.13G of the Buy-back Regulation.

[240] See arts 4, 5 and 6 of the EU Market Abuse Regulations and MAR 1.1.4-1.1.12 of the Buy-back Regulation.

[241] See art 5(1) of the EU Market Abuse Regulations and MAR 1.1.9(1) of the Buy-back Regulation.

[242] See art 5(2) of the EU Market Abuse Regulations and MAR 1.1.9(2) of the Buy-back Regulation. In cases of extreme low liquidity on the relevant market, the user may exceed the 25 per cent limit provided that it informs the competent authority of the relevant market and the public of its intention to deviate from the 25 per cent limit, and provided further that it does not exceed 50 per cent of the average daily volume: art 5(3) of the EU Market Abuse Regulations and MAR 1.1.9 of the Buy-back Regulation.

transaction or orders to trade were legitimate and that they conformed with accepted market practices on the relevant regulated market. Section 118(5) of the Financial Services and Markets Act, 2000, provides a similar defence to the equivalent offence.[243]

The Code of Market Conduct sets out the factors which the Financial Services Authority would take into account when considering whether behaviour was undertaken for legitimate reasons. Some of these factors are that the transaction was undertaken pursuant to a prior legal or regulatory obligation owed to a third party; that the transaction was executed in a way that took into account the need for the market as a whole to operate fairly and efficiently; and that the transaction complied with the rules of the relevant prescribed markets concerning the proper way in which transactions are to be executed.[244]

The second requirement for this defence is that the behaviour must conform to accepted market practices on the relevant market. These are practices that are reasonably expected in one or more financial markets.[245] One factor that the Financial Services Authority would take into account when assessing whether to permit a particular market practice is the need to safeguard the operation of market forces and the proper interplay of the forces of supply and demand.[246] Prices in the market which are trading outside their normal range do not necessarily indicate that a person has engaged in manipulative behaviour with the purpose of positioning prices at a distorted level, since high or low prices relative to trading could be the result of the proper interplay of supply and demand.[247] A further factor is the degree to which the relevant market practice has had an impact on market liquidity and efficiency.[248] Behaviour of market users when trading at times and in sizes that are most beneficial to them, and in seeking the maximum profit from their dealings, will not of itself amount to distortion.[249] Such behaviour generally improves the liquidity and the efficiency of markets.[250] Other factors are the level of transparency of the relevant market practice to the whole market, and the degree to which the relevant market practice takes into account the trading mechanisms of the market and enables market participants to react properly and in a timely manner to the new market situation created by that practice.[251]

---

[243] Section 118(5) provides that '[t]he fourth [type of behaviour] . . . consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which – (*a*) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or (*b*) secure the price of one or more such investments at an abnormal or artificial level'.

[244] See MAR 1.6.6E.

[245] Practical Law Company Practice Note op cit note 128 at 23.

[246] See MAR 1 Annex 2 Accepted Market Practices.

[247] See MAR 1.6.8G.

[248] See MAR 1 Annex 2 Accepted Market Practices.

[249] See MAR 1.6.7G.

[250] Ibid.

[251] See MAR 1 Annex 2 Accepted Market Practices. The Code of Market Conduct has only one accepted market practice which does not amount to a market manipulating transaction. This practice relates to the metal market aberrations regime and it comprises behaviour which conforms with the

5.5 Honesty

According to s 1317S(2) of the Australian Corporations Act, 2001, a person accused of market manipulation may apply to a court for relief on the ground that he or she acted honestly and, having regard to all the circumstances of the case, ought fairly to be excused for the contravention. This defence applies to an alleged contravention of s 1041A (market manipulation); s 1041B(1) (false trading and market rigging: creating a false or misleading appearance of active trading); s 1041C(1) (false trading and market rigging: artificially maintaining market price); and s 1041D (dissemination of information about illegal transactions).

5.6 The Defence of Reasonable Belief and Reasonable Care

Section 123(2) of the Financial Services and Markets Act, 2000, provides that the Financial Services Authority ('FSA') may not impose a penalty on a person who has engaged in market manipulation if, after considering representations made by that person in response to a warning notice[252] sent to them by the Financial Services Authority, it finds, on reasonable grounds, that that person had believed, on reasonable grounds, that his or her behaviour had not amounted to market manipulation or that that person had taken all reasonable precautions and had exercised all due diligence to avoid such behaviour. These defences are known as the 'reasonable belief and reasonable care' defences.[253]

The Financial Services Authority has issued a very useful statement of its policy on the circumstances in which it is expected to regard a person as having these defences available.[254] Some of the factors the Authority may take into account in deciding whether the person concerned reasonably believed that his or her behaviour did not amount to market abuse, are the level of knowledge, skill and expertise to be expected of the person concerned; whether, and if so to what extent, the person can demonstrate that the behaviour was engaged in for a legitimate purpose and in a proper way; and whether, and to what extent, the behaviour complied with the rules of any relevant prescribed market or other regulatory requirements or codes of conduct or best practice to which the person is subject.[255] In relation to whether the person took all reasonable precautions and exercised all due diligence to avoid engaging in market manipulation, amongst the factors which the Authority may take into account in deciding this issue are whether,

---

London Metal Exchange's Document *Market Aberrations: The Way Forward* (published in Oct 1998), MAR 1.6.14E.

[252] In terms of s 126(1) of the Financial Services and Markets Act, 2000, if the FSA proposes to take action against a person under s 123, it must first give him a warning notice. If the FSA then decides to take action against such a person, it must give him or her a decision notice: see s 127(1).

[253] See Gower & Davies op cit note 117 at 783.

[254] This statement has been issued in accordance with s 124(3) of the Financial Services and Markets Act, 2000. It is contained in ch 14 of the Enforcement Section of the FSA Handbook, Release 064 (Apr 2007) ('ENF 14').

[255] See ENF 14.5.1G(1).

and if so to what extent, the person has followed established internal consultation procedures, or has sought the appropriate legal or other expert professional advice and has followed such advice.[256]

5.7 Chinese Walls

A Chinese Wall is a creation of a physical and an operational segregation of functions within a multi-functioning organisation.[257] This arrangement is set up in order to prevent information flowing from one group of persons or from a department in an organisation to another group of persons or to another department in the same organisation.[258] The rationale behind a Chinese Wall is to protect juristic persons from incurring liability for insider trading or market manipulation as a result of the knowledge of their employees being attributed to them in law.[259] Even though the prohibition of market manipulation in the SSA applies to juristic persons,[260] a Chinese Wall defence has not explicitly been provided for in the SSA.

In contrast, the Code of Market Conduct does make specific provision for a Chinese Wall defence to an alleged infringement of s 118(7) of the Financial Services and Markets Act, 2000, which section contains an offence equivalent to that in s 76 of the SSA. Section 118(7) prohibits the dissemination of information which gives a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading. In terms of the Code of Market Conduct, if the individual responsible for the dissemination of information within an organisation could only have known that the information was false or misleading if he or she had access to other information that was being held behind a Chinese wall or a similarly effective arrangement, that indicates that he or she did not know and could not reasonably be expected to have known that the information was false or misleading.[261]

5.8 Journalists

Journalists who have disseminated information have been afforded a specific defence in the Financial Services and Markets Act, 2000, under

---

[256] See ENF 14.5.1G(2).

[257] See Lord Millet, Alistair Alcock, AJ Boyle, Leonard S Sealy & David A Bennett *Gore-Browne on Companies* 45 ed vol 2 (1986) (Supplement 53, Aug 2005) at 42.33.

[258] Blackman, Jooste & Everingham op cit note 233 at 5.394.19.

[259] Richard Jooste 'Insider Dealing in South Africa' (1990) 107 *SALJ* 588 at 597. For a further discussion of Chinese Walls, see Cassim op cit note 11 at 46-54.

[260] 'Person' is defined in s 72 of the SSA to *include* a partnership and a trust. Section 2 of the Interpretation Act 33 of 1957 defines 'person' as including '(*a*) any divisional council, municipal council, village management board, or like authority; (*b*) any company incorporated or registered as such under any law; (*c*) any body of persons corporate or unincorporate.'. Thus, it seems that a reference to 'person' in the SSA is to both natural and juristic persons and that, therefore, the prohibition of market manipulation in the SSA applies not only to natural persons but also to juristic persons as well as to partnerships and trusts.

[261] See MAR 1.8.5E.

which, for the purposes of s 118(7) of that Act, the dissemination of information by journalists is to be assessed taking into account the journalistic codes governing their profession.[262] However, this defence does not apply if a journalist derives a direct or indirect advantage or profit from the dissemination. Article 1(2)(*c*) of the EU Market Abuse Directive contains a similar provision. This defence avoids dragging journalists who report information which later turns out to be false or misleading, into the market-manipulation regime, save where they derive an advantage or profit from such dissemination of information.[263]

It is submitted that ss 75 and 76 of the SSA are perhaps excessively stringent compared to foreign legislation as the only possible defence to market manipulation provided for is that of price-stabilisation, and possibly a definitional defence. In certain instances it may be difficult to distinguish non-manipulative trading which leads to an increase in market activity or an alteration in the market price for securities, from manipulative trading which has the same effect but is undertaken for an impermissible purpose.[264] For instance, trading at the end of the day is common because market participants monitor developments during the day before taking a position prior to the close of trading.[265] As legitimate trading is concentrated at the end of the day, it would be erroneous to regard trading at the end of the day of itself without more as evidence of manipulation.[266] A person accused of market manipulation under the SSA would not be able to raise a defence that his or her reasons for entering the transactions or orders to trade were legitimate and that he or she had conformed with accepted market practices on the relevant regulated market, or that he or she had exercised due diligence, such as seeking expert advice before acting. Moreover, even if a juristic person has established a Chinese Wall, this would not necessarily be a defence under the SSA. The fact that it may in certain instances be difficult to distinguish non-manipulative from manipulative trading practices, coupled with the dearth of defences to market manipulation in the SSA, could easily result in unjust convictions and this could have the undesirable effect of inhibiting legitimate trading. As observed earlier, the fear of inhibiting legitimate market activity has always been a reason propounded by critics of market manipulation for opposing the statutory regulation of market manipulation.

6 Penalties

The SSA renders market manipulation a criminal but not a civil offence.[267] While provision has been made in s 77 of the SSA for statutory civil liability

[262] Section 118A(4) of the Financial Services and Markets Act, 2000.
[263] See Alcock op cit note 158 at 150.
[264] See Black op cit note 27 at 1005.
[265] See Fischel & Ross op cit note 51 at 520.
[266] Ibid. They provide further examples where manipulative trades may be indistinguishable from non-manipulative trades, such as short sales and making successive bids at higher prices at 521.
[267] See s 115 of the SSA.

resulting from the offence of insider trading prohibited in s 73, sadly no such provision has been made in respect of market manipulation. Consequently, persons who suffer loss as a result of the actions of a market manipulator are left to seek their own civil remedy.[268]

The glaring omission of a statutory civil remedy for market manipulation in the SSA indicates that the South African Legislature perceives market manipulation as a wrong against the market, rather than as a wrong against those individuals directly affected. In other words, the provisions of the SSA on market manipulation appear to be aimed at the public good only, but not necessarily at individual protection, and that when both underlying objects could easily have been attained at the same time.[269] Interestingly, the Financial Markets Control Act of 1989 did provide for a statutory civil action for damages where a contravention of its ss 20, 21 or 22 caused a person to incur a loss.[270] Under that Act, the Registrar of Financial Institutions could institute a claim for the recovery of such damages on behalf of the aggrieved party if it considered it to be in the public interest.[271]

In contrast, the Australian Corporations Act of 2001 makes provision for both civil and criminal liability for market manipulation.[272] Additionally, under this Act a court may make a declaration of contravention if it is satisfied that a person has engaged in market manipulation.[273] Quite usefully, an applicant in a civil claim would be able to rely on such declaration and would not therefore be required to prove the market manipulation in the civil action.[274] The declaration of contravention thus facilitates in a very useful way the institution of civil claims for compensation that might otherwise be too costly to bring to court.[275]

In America, although no explicit civil remedy is provided for an infringement of rule 10*b*-5 of the Securities Exchange Act of 1934, the

---

[268] Luiz op cit note 150 at 183.

[269] See Henning & Du Toit op cit note 4 at 259; the New Zealand Ministry of Economic Development *Reform of Securities Trading Law: Volume Three: Penalties, Remedies and the Application of Securities Trading Law* (2002), available at *http://www.med.govt.nz/templates/MultipageDocumentPage__6293.aspx* (last consulted on 17 Mar 2008) in par 166.

[270] Section 23(3) of the Financial Markets Control Act of 1989. The Stock Exchanges Control Act of 1985 did not make provision for a civil remedy for a contravention of its s 40.

[271] Section 23(5) of the Financial Markets Control Act of 1989.

[272] Section 1041I of the Australian Corporations Act of 2001 provides that a person who suffers loss or damage by the conduct of another person who has contravened ss 1041E (false or misleading statements), 1041F (inducing persons to deal), 1041G (engaging in dishonest conduct in relation to a financial product or financial service), or 1041H (misleading or deceptive conduct in relation to a financial product or financial service), may institute a civil action to recover the amount of the loss or damage from that other person, whether or not that other person has been convicted of a criminal offence in respect of the contravention.

[273] In terms of subs 1317E(1) of the Australian Corporations Act of 2001, if a court is satisfied that a person has contravened ss 1041A (market manipulation), 1041B(1) (false trading and market rigging: creating a false or misleading appearance of active trading), 1041C(1) (false trading and market rigging: artificially maintaining market price), or 1041D (dissemination of information about illegal transactions), it must make a declaration of contravention. These provisions are known as civil penalty provisions: see s 1317E(1).

[274] See Morrell op cit note 75 at 11-2.

[275] Idem at 12.

existence of a private cause of action for an infringement of the rule is now well established,[276] although it is limited to actual purchasers and sellers of securities.[277] A civil remedy is permitted in America on grounds of equity. A Senate Report on the Bill that became the Securities Exchange Act of 1934 stated the following:

> '[I]f an investor has suffered loss by reason of illicit practices, it is equitable that he should be allowed to recover damage from the guilty party . . . .. [T]he bill provides that any person who unlawfully manipulates the price of a security, or who induces transactions in a security by means of false or misleading statements, or who makes a false or misleading statement in the report of a corporation, shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement.'[278]

It is submitted that the SSA must move away from only a statutory criminal remedy for market manipulation and that it should introduce a statutory civil remedy. A criminal remedy alone may have the effect of few successful actions being brought for market manipulation since the criminal standard of proof beyond a reasonable doubt is much more difficult to meet than the relatively lighter civil standard of proof on a balance of probabilities. In the United Kingdom, frustration over the difficulties of criminal prosecution have led the government to confer on the Financial Services Authority the power to impose penalties on persons for market manipulation based on the burden of proof that is required in a civil action.[279] If few successful actions are instituted for market manipulation, this would have the effect of rendering ineffective the deterrence to market manipulation.[280] A further reason for providing a statutory civil remedy is that the absence of such remedy may result in a victim being denied the opportunity to recover the losses which he or she incurred as a result of the market manipulation.[281]

The penalties provided for in the SSA for market manipulation are discussed below, as well as the other means that could be adopted in order to more effectively deter and combat market manipulation.

6.1 A Fine or Imprisonment

In order for a sanction for market abuse to be effective, the sanction must be sufficiently dissuasive and proportionate to the gravity of the offence and to the gains realised, and it must be applied consistently.[282] Section 115(*a*) of the SSA provides that a person who contravenes ss 75 or 76 is liable on conviction to a fine not exceeding R50 million or to imprisonment for a period

[276] See, eg, *Central Bank of Denver v First Interstate Bank of Denver* supra note 12 at 166 and 171; *Basic Inc v Levinson* supra note 89 at 230-1; *Sante Fe Industries v Green* 430 US 462 (US SC,1977) at 477; *Ernst & Ernst v Hochfelder* supra note 12 at 196; *Blue Chip Stamps v Manor Drug Stores* supra note 36 at 730.

[277] See *Blue Chip Stamps v Manor Drug Stores* supra note 36 at 730.

[278] Quoted in *Ernst & Ernst v Hochfelder* supra note 12 at 205-6.

[279] Alcock op cit note 158 at 163.

[280] Ibid.

[281] See NZ Ministry of Economic Development op cit note 269 in par 166.

[282] See Recital 38 to the EU Market Abuse Directive and art 14(1) of the EU Market Abuse Directive.

not exceeding ten years, or to both such fine and imprisonment.[283] While the maximum amount of R50 million may be strongly dissuasive, and is as such to be welcomed, it may not necessarily be proportionate to the gains realised, especially in instances where companies simply regard it as just another cost of doing business,[284] particularly where the profits realised significantly exceed the penalty imposed.

In contrast, there is no limit to the amount of the penalty that may be imposed by the United Kingdom Financial Services Authority, which is empowered to impose a penalty of such amount as it considers appropriate.[285] It is accordingly more viable for the Financial Services Authority to ensure that a proportionate penalty is imposed. The Authority has indeed imposed significant fines for market abuse on both individuals[286] and companies.[287]

Another way of ensuring that the fine imposed is proportionate, is to make provision for a separate maximum penalty for individuals and for companies, with a higher maximum penalty prescribed for the latter.

In terms of the Financial Services and Markets Act, 2000, various factors are taken into consideration in determining the appropriate amount of the fine to be imposed. Some of these factors include the adverse effect of the behaviour on the market in question; the extent to which the behaviour was deliberate or reckless; whether the person on whom the penalty is to be imposed is an individual; the amount of profits accrued or loss avoided; and the conduct following the behaviour.[288] Regarding this latter factor, in determining the amount of the fine the Financial Services Authority would take into account the degree of co-operation the accused person gave during

[283] In contrast, a contravention of s 40 of the Stock Exchanges Control Act of 1985 carried a fine (amount not specified) or imprisonment for a period not exceeding 5 years (s 48(1)(*h*)(*i*)), while a contravention of ss 20-22 of the Financial Markets Control Act of 1989 carried a fine (amount not specified) or imprisonment for a period not exceeding 5 years or to both that fine and imprisonment (s 36(1)(*a*)(*i*)).

[284] See Carlos Conceicao 'The FSA's Approach to Taking Action Against Market Abuse' (2007) 28 *The Company Lawyer* 43 at 45.

[285] Section 123(1) of the Financial Services and Markets Act, 2000.

[286] The largest fine thus far was one of GBP290 000: see Sinclair, Webster and Phillips op cit note 42.

[287] The largest fine thus far was a fine of GBP17m, one imposed on the Shell Transport and Trading Company, the Royal Dutch Petroleum Company, and the Royal Dutch/Shell Group of Companies ('Shell') for making false and misleading statements relating to the level of its oil reserves: see Conceicao op cit note 284 at 44. Shell was found to have contravened s 118(2)(*b*) of the Financial Services and Markets Act, 2000 (now s 118(5)(*a*) of the Financial Services and Markets Act, 2000) because it had announced false and misleading information about the level of its hydrocarbon reserves from the period 1998 to 2003. The reason why the information was false and misleading was because Shell had failed to put in place adequate systems to estimate reserves or to correct them until 2004, despite having received warnings from a number of internal and external sources that its publicly announced information was false and misleading. Some reasons why the level of the financial penalty imposed was considered to be proportionate to the level of abuse was because the announcements by Shell had been made knowingly and recklessly, and the inadequate controls over reserve estimations had been due to inadequate training or supervision of the responsible personnel. A proper external audit of Shell's proved reserves had also not been undertaken. See further FSA/PN/074/2004, available at *www.fsa.gov.uk/pubs/final/shell_24aug04.pdf* (last consulted on 17 Mar 2008).

[288] See ENF 14.7.4G.

the investigation of its behaviour[289] and whether any remedial steps were taken by that person from the time that the behaviour was first identified.[290] These are the types of factors that ought to be considered in determining an appropriate penalty under the SSA as well.

6.2 Administrative Penalty

In addition to a fine, the SSA stipulates an administrative penalty payable to the FSB which may be imposed by the Enforcement Committee where a person has contravened or failed to comply with the SSA.[291] An administrative penalty may be imposed both on persons who engage in insider trading as well as those who engage in market manipulation, but it is only in respect of insider trading that the Enforcement Committee may require the offender to pay a compensatory amount to the FSB for distribution to victims who were affected by the insider dealing.[292] Regrettably, no such provision is made as regards market manipulation. It is conceded that in certain instances of market manipulation it may be difficult to calculate accurately the amount of the loss incurred by victims, but in those instances where the incurred losses are calculable, the administrative penalty that is payable by the market manipulator to the FSB ought to be distributed to victims of the market manipulation, as is the case with insider trading.

6.3 Public Statements

In instances where the Financial Services Authority is empowered to impose a penalty on a person for engaging in market manipulation, it may instead publish a statement to the effect that such person has engaged in market manipulation.[293] The reason for substituting the publication of a statement for the imposition of a penalty is because the Financial Services Authority may be of the view that not all cases of market manipulation warrant enforcement action and that in certain instances a public statement may well be a more appropriate sanction.[294] One factor that may influence the Financial Services Authority into publishing a statement instead of imposing a financial penalty is that the person concerned has admitted the manipulative behaviour and has given full and immediate co-operation to the Authority, or has taken steps to ensure that those who have suffered loss are compen-

[289] In imposing a penalty of GBP17m on Shell for making false and misleading statements in relation to the level of its oil reserves, the FSA stated that if Shell had not co-operated in its investigation, the level of the penalty would have been significantly higher: see FSA/PN/074/2004 op cit note 287.

[290] See ENF 14.7.4G(5).

[291] The Enforcement Committee is a committee established by the FSB: see s 97 of the SSA. The Registrar or Deputy Registrar of Securities Services or the Directorate of Market Abuse are empowered to refer market abuse matters for consideration to the Enforcement Committee, which is empowered to impose an administrative penalty on a person accused of market abuse: see ss 94(*e*) and 102-105 of the SSA.

[292] See ss 77 and 105 of the SSA.

[293] Section 123(3) of the Financial Services and Markets Act, 2000. This is the so called 'name and shame' approach.

[294] See ENF 14.4.1G.

sated.[295] The Financial Services Authority would also take into account the impact of the financial penalty on the person concerned in deciding whether to opt for the publication of a statement. If, for instance, a person cannot afford to pay the financial penalty which the behaviour would otherwise attract, the Authority could decide to merely make a public statement to the effect that such person has engaged in market manipulation.[296]

It is submitted that the FSB should also consider making such public statements to the effect that persons have engaged in market manipulation, in conjunction with a penalty, as potential market manipulators who know that their identity and manipulative activities could be publicly reported may be deterred from engaging in such behaviour.

6.4 Preventative Measures

In addition to imposing stringent penalties for market manipulation, another strategy to combat such manipulation would be to implement measures that would prevent it, as opposed to merely having measures that would deter it.

Such preventative measures have already been introduced by the EU Market Abuse Directive. For instance, its art 6(9)[297] obliges Member States to implement obligations on 'any person professionally arranging transactions[298] in financial instruments who reasonably suspects that a transaction might constitute . . . market manipulation' to notify the competent authority without delay. This effectively means that part of the burden of preventing market manipulation is placed on third-party advisers and intermediaries who actively facilitate a transaction.[299]

Rule 8.10.7 of the JSE Equities Rules provides as follows:

> 'A member shall deal with the JSE as its regulator in an open and co-operative manner and keep the JSE promptly informed of anything concerning the JSE which *might reasonably be expected to be disclosed to it*.' (my emphasis)

While rule 8.10.7 does not explicitly require a member to notify the JSE of a reasonable suspicion of market manipulation, it is submitted that such a

[295] See ENF 14.6.2G(3).

[296] See ENF 14.6.2G(6).

[297] Supplemented by arts 7-11 of Commission Directive 2004/72/EC of 29 Apr 2004, implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions: see *Official J* L162 of 30 Apr 2004 ('Directive 2004/72/EC').

[298] 'Person professionally arranging transactions' is defined as meaning 'at least an investment firm or a credit institution': art 1(3) of Directive 2004/72/EC. An 'investment firm' is defined as meaning a legal person whose regular occupation or business is the provision of investment services for third parties on a professional basis: see art 1(2) of Council Directive 93/22/EEC of 10 May 1993 on Investment Services in the Securities Field, *Official J* L141 of 11 Jun 1993. A 'credit institution' is defined as an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account: see art 1(1) of Directive 2000/12/EC of the European Parliament and of the Council of 20 Mar 2000 relating to the taking up and pursuit of the business of credit institutions: see *Official J* L126 of 26 May 2000.

[299] See Alexander op cit note 157.

suspicion would 'reasonably be expected to be disclosed' to the JSE and that members ought to report such a suspicion to the JSE. However, no legal duty has been imposed on professional intermediaries to report such suspicions of market manipulation to the JSE. This responsibility on third parties to report suspicions of market manipulation would be similar to that which exists as regards money laundering for accountable institutions – which includes banks, attorneys, estate agents and gambling institutions – in terms of s 29 of the Financial Intelligence Centre Act 38 of 2001.

Regarding other preventative measures, art 6.5 of the EU Market Abuse Directive[300] obliges Member States to ensure that there is appropriate regulation in place to ensure that persons who produce or disseminate research concerning financial instruments, issuers of financial instruments, and persons who produce or disseminate information recommending or suggesting investment strategies[301] intended for distribution channels[302] or for the public, take reasonable care to ensure that such information is fairly presented,[303] and that they disclose their interests or that they indicate conflicts of interest concerning the financial instruments to which that information relates. Rules 8.20.2 and 8.20.3 of the JSE Equities Rules prescribe rules to be followed by members in respect of any advertisement,[304] while rule 8.20.6 requires members to disclose a conflict of interest where a newsletter, circular or other publication contains an expression of opinion on a listed company and the member has an interest in that company.

It is submitted that more emphasis should be placed on imposing a duty on market participants to take preventative measures to combat market manipulation. If such participants played a bigger role in preventing and

[300] Supplemented by Commission Directive 2003/125/EC of 22 Dec 2003, implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest: see *Official J* L339 of 24 Dec 2003 ('Directive 2003/125/EC').

[301] 'Research or other information recommending or suggesting investment strategy' refers to information produced by an investment firm, a credit institution, any other person whose main business is to produce recommendations, a natural person working for these persons or information produced by persons which directly recommends a particular investment decision in respect of a financial instrument: see art 1(4) of Directive 2003/125/EC.

[302] A distribution channel is one through which information is, or is likely to become, publicly available, ie, information to which a large number of persons have access: see art 1(7) of Directive 2003/125/EC.

[303] For instance, facts must be clearly distinguished from interpretations, estimates, opinions and other types of non-factual information; all sources must be reliable, or where there is any doubt as to whether a source is reliable, this must be clearly indicated; and all projections, forecasts and price targets must be clearly labelled as such and the material assumptions made in producing or using them must be indicated: see art 3(1) of Directive 2003/125/EC.

[304] Some of these rules are that the advertising material must provide accurate, complete and unambiguous information about any JSE authorised investment; it must discern fact from opinion; it may not contain any statement, promise or forecast which is fraudulent, untrue or misleading; if it contains performance data, it must include references to their source and date; if it contains illustrations, forecasts or hypothetical data, it must make it clear that they are not guaranteed and are provided for illustrative purposes only; and if it contains information about past performances, it must contain a warning that past performances are not necessarily indicative of future performance.

detecting market manipulation, this would surely have the effect of diminishing the extent of market manipulation.[305]

7 Conclusion

It is submitted that the provisions of the SSA regulating market manipulation certainly have the potential of achieving the object of promoting the international competitiveness of securities services in South Africa and of enhancing confidence in the South African financial markets. Not only has the offence been tightened up in the SSA compared to its regulation in the Stock Exchanges Control Act of 1985 and the Financial Markets Control Act of 1989, but the legislation is undoubtedly for the most part generally in harmony with, and, in certain instances, even more far-reaching than foreign legislation.

For instance, s 75(1) of the SSA appears to have imposed strict liability for the offence of using a prohibited trading practice, while in America the courts have read a fault requirement into the equivalent prohibition contained in rule 10*b*-5 of the Securities Exchange Act of 1934. Section 75(1) of the SSA also makes it clear that a secondary actor who aids or assists a market manipulator would be guilty of market manipulation, provided he or she had the necessary mens rea at the time of the participation, whereas this issue has been contentious in America where, after much fierce debate, it has been decided that the equivalent provision contained in rule 10*b*-5 does not, in a private action, extend to secondary actors who aid and abet another in market manipulation.

Section 76 of the SSA is also wider than the equivalent measures in America, the European Union and the United Kingdom in that it not only prohibits the making or publishing of false statements in respect of listed securities, but also prohibits such statements being made in respect of the past or future performance of a public company. Moreover, unlike the equivalent legislation in the European Union, the United Kingdom and Australia the SSA prohibits both the making of false, misleading or deceptive statements, promises or forecasts as well as the omission or concealment of a material fact that renders a statement, promise or forecast false, misleading or deceptive.

The SSA is further particularly far reaching in that, unlike the position in the European Union and the United Kingdom, it does not require any territorial link with South Africa in order for a market manipulation offence to be committed under the Act.

Yet in other respects the market manipulation provisions of the SSA fall short when compared to legislation in other jurisdictions, particularly when it comes to the defences to market manipulation.

The only defence provided for market manipulation is a price-stabilisation defence. It is submitted that a definitional defence could also be raised. In

[305] See Conceicao op cit note 284 at 44.

contrast, leading foreign jurisdictions have provided a host of defences that may be raised, such as share buy-back programmes; the defence that the accused person's reasons for entering the transaction or orders to trade were legitimate and conformed with accepted market practices on the relevant regulated market; the defence that the accused person has acted honestly and having regard to all the circumstances of the case ought fairly to be excused for the contravention; the defence that the accused person believed, on reasonable grounds, that his or her behaviour did not amount to market abuse or that such person had taken all reasonable precautions and had exercised all due diligence to avoid such behaviour; a Chinese Wall defence; and a specific defence that applies to journalists.

In certain instances it may be difficult to distinguish non-manipulative trading, which leads to an increase in market activity or the market price for securities, from manipulative trading, which has the same effect but is undertaken for an illegitimate purpose. This fact, coupled with the lack of defences to market manipulation in the SSA, could result in unfair convictions and could discourage legitimate trading. Fear of discouraging legitimate market trading has always been a reason for some critics of market manipulation contending that the offence ought not to be statutorily regulated at all.

A more serious defect of the SSA is the glaring failure to provide for a statutory derivative civil remedy for market manipulation. This could have the effect of few successful actions being instituted for market manipulation and may have the effect of not effectively deterring persons from engaging in market manipulation. It could also result in victims of market manipulation being denied the opportunity to recover their losses. The absence of a statutory civil remedy seems to indicate that the Legislature regards market manipulation as a wrong against the market, rather than as a wrong against those individuals directly affected, and perhaps this is not the proper or ideal approach.

While the harsh penalties introduced by the SSA may go some way toward deterring market manipulation, they may not necessarily be proportionate or be a sufficient deterrent on their own. It is submitted that they ought to be supplemented with other penalties relied on in leading foreign jurisdictions. In addition, more emphasis should be placed on enhancing preventative measures to combat market manipulation. Importantly, we must not lag behind other jurisdictions and we too should take firm steps to adopt policies and procedures to identify and control market manipulation on the Internet. In particular, more attention must be given to educating Internet investors about market manipulation via the Internet.

In conclusion, the SSA's provisions on market manipulation are certainly internationally competitive and commendable. But it is hoped that the paucity of defences for market manipulation in the SSA and the absence of statutory civil liability for market manipulation will not prove to be fatal weaknesses of the market manipulation regime in South Africa.