



Corporate Advisory

SIMPSON GRIERSON

FEBRUARY 2008

Clamping down on market manipulation

Introduction

A number of important changes are about to be made to New Zealand's securities law. The Securities Markets Amendment Act 2006 (**Amendment Act**), which is to come into force on 29 February 2008, will amend the Securities Markets Act 1988 (**Act**) and includes far-reaching changes to insider trading laws, changes to the disclosure by substantial security holders, new market manipulation provisions and a general dealing misconduct provision, and new disclosure requirements for investment advisers and investment brokers.

In this, the second of a series of publications on the changes, we consider provisions relating to market manipulation and general dealing misconduct. This publication follows last week's release on the changes to the insider trading regime. Separate publications will be released over the next few weeks to address other changes to the Act.

Overview of Market Manipulation

The new market manipulation regime seeks to increase the integrity of New Zealand's securities market by prohibiting conduct which would mislead the market as to the price of a security, the volume traded, or the way in which a person votes on a transaction in relation to a security. Specifically, the regime, prohibits a person from:

- making false or misleading statements and from

disclosing false or misleading information (**disclosure based manipulation**); and

- creating a false and misleading appearance of trading (**trade based manipulation**).

The Amendment Act also introduces a general dealing misconduct prohibition, which prohibits misleading or deceptive conduct and conduct that is likely to mislead or deceive in relation to securities.

Prior to the introduction of the new regime, there was no specific prohibition on the behaviours mentioned above (although, some of the conduct would arguably be prohibited by section 9 of the Fair Trading Act 1986).

“The new market
manipulation regime
seeks to increase the
integrity of New
Zealand's securities
market ...”

Disclosure Based Manipulation

The disclosure based manipulation prohibition prohibits a person from making false or misleading statement or spreading false or misleading information that affects:

- securities listed on a registered exchange or traded on an authorised futures market; or
- the way that a person votes on a transaction involving securities.

This prohibition is very wide and has the potential to apply to written and oral statements, as well as information that is contained in pictures or graphs.

The Securities Commission has stated that "every important aspect of the information or statement must be accurate and balanced. The information or statement as a whole must be accurate and balanced. Statements or information will be prohibited if they omit important aspects, and the omission makes the statement or information as a whole materially misleading."

With this in mind, issuers and market participants will have to be careful when communicating with the public, especially via electronic means such as by email or websites.

Trade Based Manipulation

The trade based manipulation prohibition prohibits a person from trading a security with the object of misleading or deceiving other market participants about the value or trading volume of that security. The reason for prohibiting these sorts of trades is that they may be used by a person to influence the price of a security to the benefit of that person.

People who routinely trade securities should note that the new regime deems two types of behaviour to contravene the prohibition. These are where a person:

- trades securities and there is no apparent change in the beneficial control of the securities; or
- sells securities and that person or that person's associate places a matching purchase order.

However, these presumptions will not apply to a trade where it can be proved that:

- the security was traded for a legitimate reason;
- the trade was done on behalf of another person; or
- the person who traded did not know that the trade would not result in a change of beneficial ownership.

The Securities Commission has indicated that this prohibition is designed to address practices such as:

- **matched orders** - transactions where buy and sell orders are entered at the same time, with the same price and quantity, by different but colluding parties

- **wash sales** - transactions in which there is no real change in ownership of the security
- **runs** - creating the appearance of significant activity in a security by successive buying or selling that security, with the intention that the activity will induce others to buy and push up the price of the securities
- **marking the close** - buying or selling securities at the close of the market to try to alter the closing price of the security

Exceptions and Exemptions for Market Manipulation

While the new regime broadly applies to the spreading of information and trading in relation to any public issuer, it does not apply to conduct regulated under the Takeovers Act 1993 or the Takeovers Code.

There are three exemptions from the market manipulation provisions (each reflecting what is regarded as legitimate market practice). These are contained in the Securities Markets (Market Manipulation) Regulations 2007 and relate to market stabilisation, short selling, and crossings:

- **Market Stabilisation:**

Stabilisation is the process of providing short term price support following an initial public offer (IPO). Stabilisation is exempt from the market manipulation regime, subject to it being conducted in a manner consistent with certain specific criteria, which include the following:

- the stabilisation must not raise the price of the securities or be undertaken with the intention of creating a false or misleading market for the securities
- the total value of the IPO must be more than \$30 million and the over-allotment associated with the stabilisation must not exceed 15% of the total value of the IPO
- the stabilisation can only be undertaken during a 30 day period
- the issuer must disclose the nature and effect of the stabilisation and certain other details before the IPO is undertaken

“The trade based manipulation prohibition prohibits a person from trading a security with the object of misleading or deceiving other market participants...”

- **Short Selling:** Short selling is a sale of securities where, at the time of the sale, the seller does not own the securities. Short selling is deemed to not by itself be market manipulation, unless it is done with the intention of manipulating the market.
- **Crossings:** Crossings are a process where securities are traded in off-market transactions that are subsequently reported to the market. These transactions involve the sale and purchase of securities where a person acts as:
 - the buyer and seller in an agency capacity; or
 - the buyer or seller on one side of the transaction in an agency capacity and as a principal on the other side.

As with short selling, crossings are deemed to not by themselves be market manipulation, unless they were done with the intention of manipulating the market.

Enforcement and Remedies

The penalties for breaching the market manipulation provisions include:

- criminal liability (including a maximum of five years in prison and a fine of \$300,000 for an individual and \$1 million for a body corporate where a person knowingly breaches the market manipulation provisions)
- pecuniary penalties (the greater of three times the loss or gain, the value of the transaction or \$1 million)
- civil liability (any person who has suffered loss as a result of a breach of the market manipulation provisions can go to court to seek compensation)
- management banning orders (including an automatic five year ban for persons found guilty of committing an offence or persons who have had a pecuniary penalty ordered against them)
- court injunction (any person can go to court and get an injunction to stop a person from doing something that would breach the market manipulation provisions)
- prohibition and corrective orders from the Securities Commission

Where the Securities Commission applies for a pecuniary penalty order in respect of any alleged breach, the Court must make a declaration of contravention if satisfied that the person has contravened a civil remedy provision. The importance of this is that this declaration can be used by an individual as a basis for seeking compensation from the manipulator.

General Dealing Misconduct Prohibition

In addition to the market manipulation prohibitions, the new regime also introduces a general prohibition against conduct in relation to securities that is misleading or deceptive or likely to mislead or deceive unless one of the exceptions contained in the Act applies.

This is broader than the market manipulation prohibitions in that it applies not only to trading of securities but also to:

- offering, allotting and issuing securities;
- underwriting securities; and
- unless exempt under the Act, any act that is preparatory to dealing in securities.

This prohibition not only applies to publicly traded securities, but all securities where any of the above steps were taken in the course of business.

“...the new regime also introduces a general prohibition against conduct in relation to securities that is misleading or deceptive...”

Exceptions

The general dealing misconduct regime does not apply to some types of conduct that are regulated by other laws. In particular, the regime does not apply:

- where the conduct is regulated by the Takeovers Act 1993 or the Takeovers Code
- in relation to the acquisition or redemption by a company of its shares under the Companies Act 1993
- in relation to the offer of securities to the public under the Securities Act 1978, or any conduct in relation to the issue or allotment of those securities
- in relation to the activities of an investment adviser or broker that are regulated by the Securities Markets Act 1988

Enforcement and Remedies

The new regime introduces the following remedies in relation to the general dealing misconduct prohibition:

- civil liability (any person who has suffered loss as a result of a breach of the general dealing misconduct prohibition can go to court to seek compensation)
- corrective orders and prohibition orders from the Securities Commission

- court injunction (any person can go to court and get an injunction to stop a person from doing something that would breach the general dealing misconduct prohibition)

The general dealing misconduct prohibition carries civil sanctions only and the Securities Commission cannot seek pecuniary penalties. The courts cannot make a declaration of contravention and any individuals who are seeking compensation must prove liability and loss.

This article was prepared by Michael Pollard, partner, and Keegan Toft, associate, in the Corporate Advisory team of Simpson Grierson.

Contact Information



Shelley Cave, Partner

DDI: 09 977 5260 Fax: 09 977 5067
Mobile: 021 660 090
shelley.cave@simpsongrierson.com



Kevin Jaffe, Partner

DDI: 09 977 5057 Fax: 09 977 5036
Mobile: 021 987 430
kevin.jaffe@simpsongrierson.com



Don Holborow, Partner

DDI: 04 924 3423 Fax: 04 472 6986
Mobile: 029 924 33423
don.holborow@simpsongrierson.com



Alex Campbell, Senior Associate

DDI: 09 977 5094 Fax: 09 977 5067
Mobile: 021 918 311
alex.campbell@simpsongrierson.com



Peter Hinton, Partner

DDI: 09 977 5056 Fax: 09 977 5067
Mobile: 021 446 866
peter.hinton@simpsongrierson.com



Michael Pollard, Partner

DDI: 09 977 5432 Fax: 09 977 5067
Mobile: 021 400 852
michael.pollard@simpsongrierson.com



Charlotte Clitherow, Senior Associate

DDI: 09 977 5411 Fax: 09 977 5067
Mobile: 021 410 577
charlotte.clitherow@simpsongrierson.com



Keegan Toft, Associate

DDI: 09 977 5264 Fax: 09 977 5067
keegan.toft@simpsongrierson.com



This newsletter is produced by Simpson Grierson. It is intended to provide general information in summary form. The contents do not constitute legal advice and should not be relied on as such. Specialist legal advice should be sought in particular matters.

© Simpson Grierson 2008

Office Locations

Auckland Office

88 Shortland Street,
Private Bag 92518, Auckland, New Zealand
Tel +64 9 358 2222 Fax +64 9 307 0331
DX CX 10092.

Wellington Office

HSBC Tower, 195 Lambton Quay,
PO Box 2402, Wellington, New Zealand
Tel +64 4 499 4599 Fax +64 4 472 6986
DX SX 11174.
E-mail: info@simpsongrierson.com
Website: www.simpsongrierson.com

Christchurch Office

PO Box 874, Christchurch 8140,
New Zealand
Tel +64-3-365 9914 Fax +64-3-379 5023