

AN IMMUNITY POLICY FOR INSIDER TRADING AND MARKET MANIPULATION?

LCA Corporations Workshop

20-21 September 2008

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Outline

1. Introduction: Should more songbirds be induced to sing?

It has been suggested that the enforcement of the prohibitions against insider trading and market manipulation under the *Corporations Act 2001* (Cth) would be assisted by the introduction of an immunity policy comparable to the ACCC's Immunity Policy. See E Mayne and D Lawrence "ASX Markets Supervision", 11th Annual SDIA Conference, Melbourne – 22 May 2008.

David Lawrence:

Personally, I believe it is time that a leniency policy akin to that applied by the ACCC to cartels is seriously considered. Insider trading invariably involves 2 or more people. A cartel-style leniency policy would have those involved looking over their shoulder, not just at the regulators and others in the market who may be watching, but at their partners-in-crime, wondering who will crack first. This would, I believe, be a significant step in reducing insider trading

This suggestion goes considerably beyond the protection of whistleblowers (ASIC Information Sheet 0052, *Protection for Whistleblowers*), the process for making enforcement action submissions (ASIC, Regulatory Guide 15 (1994)) and the incentive resulting from discounts for co-operation in sentencing (eg *R v Howard* (2003)).

The use of a formal immunity policy as a weapon against cartel conduct was pioneered by the US Department of Justice in the early 1990s. A similar approach is now used by competition law enforcement agencies around the world (see K Arquit & O Antoine (eds), *Leniency Regimes: Jurisdictional Comparisons* (2nd ed, 2007)). The ACCC Immunity Policy (2005) has been a major success in bringing numerous cartels to the attention of the ACCC. Under this Policy, the first person (corporation or individual) to come forward with information

about cartel conduct and enter into an agreement to co-operate in the pursuit of proceedings against the other cartel participants receives immunity from enforcement action by the ACCC. The grant of immunity is subject to certain conditions (eg the applicant must not be a ringleader; and the ACCC must not have received legal advice that has sufficient evidence to bring proceedings).

The idea behind immunity policies is to provide a strong incentive to participants in a joint illegal enterprise to break the bond of common trust and to defect by informing and co-operating with an enforcement authority. There is an illuminating explanation of how this incentive works in C Leslie, "Antitrust Amnesty, Game Theory, and Cartel Stability" (2006) 31 *Jnl of Corporation Law* 453.

The US SEC has a general leniency policy (see "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions," Exch. Act Rel. No. 44969 (Oct. 23, 2001), http://www.sec.gov/litigation/investreport/34-44969.htm#P54_10935). Little public enforcement appears to be available about the extent to which the SEC leniency policy is used in the context of insider trading and market manipulation.

The FSA has proposed that cooperation be an explicit factor to be taken in account in deciding whether or not to prosecute an individual for market abuse or to bring other proceedings (Consultation Paper 08/10, *Decision Procedure and Penalties Manual and Enforcement Guide Review 2008* (May 2008) 2.18-2.28). Unlike the ACCC Immunity Policy, the approach proposed is discretionary and does not envisage the automatic grant of immunity if certain conditions are satisfied. Nonetheless, it is interesting that the FSA regards an offer of discretionary immunity as an important incentive in the context of insider trading and market manipulation:

Leniency for suspects who assist our market misconduct investigations

2.18 There are very real challenges in prosecuting insider dealing and other market misconduct offences. Gathering the necessary evidence to take successful enforcement action, including criminal prosecution, has always been difficult. This is a reflection of the nature of the offences, but the evidential difficulties are particularly acute when we face organised and sophisticated criminals who are careful to take steps to cover their tracks. We are pursuing a range of work to improve our ability to tackle market abuse. This includes looking at ways to strengthen our formal powers and examining the range of tools at our disposal. Our efforts are also directed at

improving the controls authorised firms put in place to safeguard against the misuse of information; and we are working to improve our ability to monitor the market and detect abnormal share price movements. But we have also made clear that we are prepared to bring more criminal prosecutions to achieve our goal of credible deterrence.

2.19 We regard cases in which two or more people act together to engage in, or attempt to engage in, market misconduct as particularly serious and a powerful factor in favour of criminal prosecution. However, we also believe there is a strong public interest in encouraging people who have been involved in such activities to come forward and be full and frank with us about their involvement, and the involvement of others, so we can uncover the extent of the misconduct.

2.20 To provide a greater incentive to cooperate, we wish to articulate more clearly and openly that, where misconduct is carried out by two or more individuals acting together and one of the individuals provides information and gives full assistance in our prosecution against the other(s), we will take this cooperation into account when deciding whether to prosecute the individual who has assisted us or to bring market abuse proceedings against him. We propose to do this by adding an additional factor to the non-exhaustive list of factors at EG 12.8 that we may consider when deciding whether to prosecute a market misconduct offence or to impose a sanction for market abuse.

2.21 The emphasis we intend to give to this factor will not affect our obligations under the Code for Crown Prosecutors. Like all prosecutors, we must apply the Code when deciding whether to bring a criminal prosecution. The Code requires that both an evidential and a public interest test be considered in deciding whether a prosecution is appropriate. What we propose does not in any way change the fact that we will need to consider in each case whether it is in the public interest to prosecute someone despite any assistance he may have provided to us. So our proposal does not amount to a guarantee that suspects who come forward will not be prosecuted. We hope nonetheless that it will be a strong incentive for them to do so.

2.22 We expect that the considerations we would take into account when making the public interest assessment in each case would generally include the seriousness of the offence; the value of the assistance provided; and the suspect's relative culpability. Where we decide that it is not appropriate to prosecute, we will still need to consider whether to take civil market abuse or regulatory action. Depending on the facts of the

case, this could mean that we issue a public censure against the individual or impose a financial penalty on him. Generally, we would expect that such penalty would include disgorgement of any profit the individual had made. The penalty may or may not also have a punitive element.

2.23 It is also important to understand that we currently have no power to grant a formal immunity from prosecution which will bind other prosecutors. (At common law the Attorney General has such a power, although this now operates alongside the statutory framework for the giving of immunity, set out in the Serious Organised Crime and Police Act 2005.) It is possible – at least in theory – that other prosecutors could decide to prosecute in circumstances where we have agreed not to do so. But this is already in fact a possibility where we take action for civil market abuse when the relevant conduct might also have constituted a breach of the criminal law. It would be open to other prosecutors to take criminal action in such circumstances despite our decision to pursue civil action only.

2.24 We are convinced that the threat of a criminal conviction is a significant and effective deterrent to wrongdoing. We believe that encouraging suspects in market misconduct investigations to give evidence against their accomplices will help to maximise the impact of this deterrent by making stronger the likelihood and belief that individuals who engage in market misconduct will be caught and prosecuted. A policy of leniency towards those who assist us to bring others to justice can improve the efficiency of our investigations by providing access to evidence that we might not otherwise be able easily to obtain. This in turn will help us to bring more, and successful, prosecutions.

2.25 During pre-consultation, trade associations raised with us their concerns that this proposal would encourage individuals to pass the blame for their actions onto firms in the hope of securing a civil or regulatory rather than a criminal sanction. They also expressed concern that the proposal may damage the environment of constructive engagement between firms and the FSA and increase the costs to firms of handling market misconduct investigations. They said, for example, that it might create an environment in which firms feel the need to engage external counsel, or to do so earlier than they otherwise might.

2.26 Our proposal is targeted at any individual who engages in market misconduct, not just at employees of regulated firms, and we expect that in most cases the issues identified by trade associations will not arise. However, with any investigation of this

nature there is a risk that individuals will seek to pass the blame for their actions onto others. We do not consider that our proposal will significantly increase that risk. Nor do we believe that, in those cases which do involve firms, our proposal will lead to increased costs for firms in dealing with situations in which misconduct by their employees is uncovered. We expect firms to continue to engage with us in such situations, given the common interest we have in identifying and dealing with offenders.

2.27 In respect of concerns over the reliability of evidence obtained as a result of this proposal, it is clear that we would need to satisfy ourselves that information provided by individuals was truthful and complete. This includes requiring that individuals give us a full and frank account of their own participation in any misconduct. We do not envisage that the evidence we obtain from suspects in these cases will be used as the sole basis of action, but rather to corroborate other evidence.

2.28 We believe our proposal will improve our capability for bringing successful market misconduct prosecutions by encouraging some individuals, particularly those whom we are already investigating and who are not otherwise subject to our regulatory requirements, to cooperate sooner and/or more fully than they otherwise might in the knowledge that we will take this cooperation into account in the circumstances set out in the proposed EG12.8(12A).

Several questions arise:

- (1) Is there any need in Australia for an immunity policy in the context of insider trading or market manipulation? Is cartel conduct a special case?
- (2) Is an immunity policy like the ACCC Immunity Policy consistent with the Prosecution Policy of the Commonwealth? There is very limited scope for immunity under that Policy.
- (3) Is an immunity policy like the ACCC Immunity Policy consistent with the retributive dimension of criminal liability?
- (4) What possible lessons emerge from the ACCC Immunity Policy and other similar immunity policies around the world?

2. Is there any need in Australia for an immunity policy in the context of insider trading or market manipulation? Is cartel conduct a special case?

The difficulty of detecting and deterring insider trading and market manipulation is notorious. This difficulty animates the suggestion that use be made of an immunity policy to ferret out more cases.

But are cartels a special case for the adoption of an immunity policy?

The incentive to squeal on which anti-cartel immunity policies are based is also relevant in the context of market manipulation and insider trading where several parties have colluded or have engaged in a transaction.

Insider trading typically involves two parties, namely tipper and tippee. One well-known example is the insider trading by Ivan Boesky under a deal with Dennis Irvine under which Boesky paid Levine a percentage of the profit made by trading on Irvine's tips.

Market manipulation may involve joint action or collusion by two or more parties, as in the context of pools and runs or collusion between hedge funds to depress share prices by means of short selling.

It is difficult to distinguish insider trading from cartel conduct on the basis that the conduct is easier to detect. Market manipulation may be easier to detect given the record of trades from which patterns of manipulation may be discerned but difficulty nonetheless arises.

Nor does it seem plausible to attempt a distinction on the basis that the actual or likely harm to market integrity is less significant in impact than the actual or likely harm to competitive markets from cartel conduct.

Does a potential immunity applicant have less incentive to apply for immunity in the context of insider trading or market manipulation than in the context of cartel conduct? It might be contended, for example, that insider traders and market manipulators stand to make high personal gains and are unlikely for that reason to be prepared to make an immunity application. However, such a contention is questionable. First, corporate rather individual participants in price fixing and other cartel conduct stand to benefit directly from overcharges that result but individuals engage in the cartel conduct and typically do so under strong corporate incentives (eg the risk of losing their job unless they improve corporate performance by engaging in cartel conduct). Secondly, at least some forms of market

manipulation closely resemble or do involve cartel conduct (eg collusive action by hedge funds to depress share prices through short selling). Thirdly, the theory of incentives underlying immunity policies applies whether or not the potential immunity applicant stands to make a little or a lot from the relevant offence. One critical threat is whether or not another party to the transaction will spill the beans. Another party who stands to gain relatively little from the transaction but who faces criminal liability unless he or she applies for immunity may well have a sufficient incentive to squeal. This fact is exploited by immunity policies, which seek assiduously to make the risk of defection by other participants prey on the mind of even the strongest participant.

3. Is an immunity policy like the ACCC Immunity Policy consistent with the Prosecution Policy of the Commonwealth?

There are very significant differences between the ACCC Immunity Policy and the Prosecution Policy of the Commonwealth. The three main differences are:

- (1) The scope of immunity is very narrow under the Prosecution Policy of the Commonwealth – that Policy is limited to cases where the evidence that the accomplice [applicant for immunity] can give is considered necessary to secure the conviction of the defendant, and that evidence is not available from other sources; and the accomplice can reasonably be regarded as significantly less culpable than the defendant. By contrast, there are few limitations on immunity under the ACCC Immunity Policy (eg the applicant must not be a ringleader; the ACCC must not have legal advice confirming that is sufficient evidence already).
- (2) The decision to grant immunity is made at a late stage of an investigation. By contrast, under the ACCC Immunity Policy the decision is made at an early stage.
- (3) Immunity is highly discretionary under the Prosecution Policy of the Commonwealth. Immunity may be granted where “it is in the overall interests of justice that the opportunity to prosecute the accomplice in respect of his or her own involvement in the crime in question should be foregone in order to secure that person’s testimony in the prosecution of another.” By contrast, immunity is automatic under the ACCC Immunity Policy if D meets the conditions set out in the Policy.

These differences have not been resolved by the Draft MOU released by the government for public comments in January 2008; see C Beaton-Wells & B Fisse, “Criminalising Serious Cartel Conduct: Issues of Law and Policy” (2008) 36 ABLR 16, Parts 13.4, 13.5. Under the Draft MOU, the ACCC will decide whether to grant immunity from civil proceedings in accordance with the ACCC’s Immunity Policy ([7.3]). Where the matter also concerns criminal investigation or prosecution, the ACCC will consult with the DPP in relation to the management of applications for immunity from civil proceedings and in relation to decisions as to whether or not to grant such immunity ([7.5]).

Responses to the arrangements for immunity outlined in the Draft MOU have been critical. See C Beaton-Wells, “Forks in the Road: Challenges Facing the ACCC’s Immunity Policy for Cartel Conduct: Part 1” (2008) 16(1) Competition and Consumer Law Journal 71 at 84-85.

It is highly likely that the ACCC Immunity Policy will be extended to apply to criminal cartel cases and that the Prosecution Policy of the Commonwealth will be amended or qualified accordingly. Any other approach would undermine the immunity policy in its application to civil penalty proceedings. No potential snitch will want to seek immunity from a civil penalty prohibition unless the immunity also applies to the cartel offences. No Australian government is likely to tolerate any undermining of the ACCC Immunity Policy. The Chairman of the ACCC is reported to have said that it is a “furphy” to suggest that the ACCC’s approach to immunity will not be adopted (E Sexton, ‘To catch a cartel’, SMH, 21 March 2008, p 35).

Guidance is available from overseas models:

- The US Department of Justice handles and makes the immunity decision in cartel investigations. There is no Director of Public Prosecutions.
- Under the Office of Fair Trading model in the UK, OFT handles and makes the immunity decision, not the Serious Fraud Office or any other agency - OFT, *The cartel offence: Guidance on the issue of no-action letters for individuals*, April 2003, at http://www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft513.pdf; OFT, *Leniency and no-action: OFT's draft final guidance note on the handling of applications*, OFT803, November 2006, s 4, at http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft803a.pdf.

- Under the Canadian model, criminal immunity is decided upon by the DPP in accordance with the policy set out in Federal Prosecution Service Deskbook. The Deskbook has a separate section that gives special recognition to immunity from prosecution under the *Competition Act 1985* (Can) and refers to Bureau of Competition's immunity policy. See Public Prosecution Service of Canada, FPS Deskbook, [35.4.5], at <http://www.ppsc-sppc.gc.ca/eng/pub/fpsd-sfpg.html>, and the sample immunity agreements in the Deskbook Appendices. No recommendation for immunity in a competition case has been rejected by the Canadian DPP.

See further C Beaton-Wells, "Forks in the Road: Challenges Facing the ACCC's Immunity Policy for Cartel Conduct: Part 1" (2008) 16(1) *Competition and Consumer Law Journal* 71 at 87-92.

Legislation is probably unnecessary but s 190(4) of the *Enterprise Act 2002* (UK) provides a precedent for a legislative approach to overcoming the problem of creating an exception to a general DPP policy.

The adoption by the ACCC of a Leniency Policy in 2003 and the current Immunity Policy in 2005 did not conflict with the Prosecution Policy of the Commonwealth because the Leniency Policy and Immunity Policy related to civil penalty prohibitions and there were no cartel offences under the Trade Practices Act. By contrast, when civil penalties were introduced for market manipulation and insider trading, offences against such conduct were already in place. The Prosecution Policy of the Commonwealth applied to those offences and an ACCC immunity policy had yet to be adopted. However, history is history. Assuming that the ACCC Immunity Policy (or some close variant thereof) will be adopted for the enforcement of the new cartel offences, and that the Prosecution Policy of the Commonwealth will be amended to accommodate that Immunity Policy, other enforcement agencies including ASIC and the ATO may wish to follow a similar path. It would seem arbitrary and indeed extraordinary to accommodate only the ACCC Immunity Policy.

4. Is an immunity policy like the ACCC Immunity Policy consistent with the retributive content of criminal liability?

Immunity from criminal liability has been frowned on by those concerned to uphold the retributive content of the criminal law. Consider eg these views of Justice Roger Gyles ((2008) 36 ABLR 241 at 242):

Experience in other fields teaches that there will be difficulties in coordination between a statutory regulator and the prosecution authorities. The areas of competence and experience of each are quite different. The objectives and priorities of each are different. There are different cultures. I agree that immunity from prosecution will be the area of sharpest tension. My experience has led me to have a certain caution about the necessity for, and the utility of, the grant of immunity, particularly in the early stages of an investigation. Amongst other things, generally speaking, it is unacceptable to grant a person immunity from prosecution in order to prosecute others with the same or a lesser degree of criminality. That assessment can often not be made at an early stage of an investigation. The ACCC's so-called leniency policy is quite the reverse; as dramatically demonstrated in the recent *Visy* case. That kind of selective pragmatism can hardly apply to the imprisonment of some executives and not others of equal or greater culpability. The usual reward for incriminating evidence is the credit to be obtained for that factor on sentence on a plea of guilty, not immunity from prosecution.

The standard response, long championed by the US Department of Justice, is that the gains in deterrence that are achievable by means of an immunity policy far outweigh the degree of inequality in the distribution of desert. See further R Christopher, "The Prosecutor's Dilemma: Bargains and Punishments" (2003) 72 *Fordham LR* 93.

For an attempt to reconcile immunity policies with the theory of retributive punishment, see M Simons, "Retribution for Rats: Cooperation, Punishment, and Atonement" (2003) 56 *Vanderbilt LR* 1.

5. What possible lessons emerge from the ACCC Immunity Policy and other similar immunity policies around the world?

Many possible lessons emerge from the ACCC Immunity Policy and similar immunity policies:

- (1) Successful as the ACCC Immunity Policy undoubtedly has been, the ACCC's track record in recent enforcement actions is not as impressive as some would have one believe; see the data and analysis in C Beaton-Wells & B Fisse, "Criminalising Serious Cartel Conduct: Issues of Law and Policy" (2008) 36 *ABLR* 166, 200-202, 239-240.

- (2) The ACCC Immunity Policy and the platform provided by the Trade Practices Act are imperfect. There are no whistleblower protection provisions (contrast *Corporations Act 2001* (Cth) Part 9.4AAA). The conditions of immunity under the current Immunity Policy (eg the condition that the applicant not be a ringleader) are open to question; see C Leslie, “Antitrust Amnesty, Game Theory, and Cartel Stability” (2006) 31 *Jnl of Corporation Law* 453; C Beaton-Wells & B Fisse, “Criminalising Serious Cartel Conduct: Issues of Law and Policy” (2008) 36 *ABLR* 16, Part 13.6.
- (3) An immunity policy is not a magic bullet but one element among many enforcement incentives and strategies. The ACCC Immunity Policy needs to be assessed along with the ACCC Cooperation Policy. The Cooperation Policy is unsatisfactory as it stands and is out of step with international best practice; see C Beaton-Wells, “Forks in the Road: Challenges Facing the ACCC’s Immunity Policy for Cartel Conduct: Part 2” (2008) 16(2) *Competition and Consumer Law Journal* (forthcoming); Canadian Bureau of Competition, *Draft Information Bulletin on Sentencing and Leniency in Cartel Cases* (June 2008); UK Attorney-General, Consultation Paper, *The Introduction of a Plea Negotiation Framework for Fraud Cases in England and Wales* (April 2008).
- (4) It may be time to consider an informant reward system comparable to eg the bounty system offered by the US SEC in relation to insider trading, the qui tam procedure under the US Civil False Claims Act, and/or the rewards offered by OFT and the Korean Fair Trade Commission for information about cartels. See E Mayne and D Lawrence, “ASX Markets Supervision”, 11th Annual SDIA Conference, Melbourne – 22 May 2008 (asking whether an approach comparable to the SEC insider trading bounty scheme should be adopted in Australia); B Chapman and R Denniss, “Using Financial Incentives and Income Contingent Penalties to Detect and Punish Collusion and Insider Trading” (2005) 37 *Australian and New Zealand Journal of Criminology* 122. The objections to informant reward systems have been exaggerated: see W Kovacic, “Bounties as Inducements to Identify Cartels” in Claus-Dieter Ehlermann and Isabela Atanasiu (eds), *European Competition Law Annual 2006: Enforcement of Prohibition of Cartels* (2007, Hart) 577. See further: M Ferziger & D Currell “Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs (1999) *Univ of Ill LR* 1141; C Beaton-Wells, “Forks in the Road: Challenges Facing the ACCC’s

Immunity Policy for Cartel Conduct: Part 2” (2008) 16(2) Competition and Consumer Law Journal (forthcoming); P Buccirossi & G Spagnolo, “Leniency Policies and Illegal Transactions” (2006) 90(6-7) Journal of Public Economics 1281.

- (5) Public regulation does not have a monopoly over the use of immunity policies. Corporate governance systems can incorporate immunity policies to assist internal self-regulation; see the instructive proposals in D Klawiter & J Driscoll, “A New Approach to Compliance: True Corporate Leniency for Corporate Executives” [2008] (Summer) Antitrust 77.
- (6) Perhaps the main lesson is that the forthcoming introduction of cartel offences in Australia is likely to lead to recognition of the ACCC Immunity Policy (or a closely similar policy) under the Prosecution Policy of the Commonwealth (see Section 3 above). When the tectonic plates of the Prosecution Policy are made to move in that way, criminal and civil immunity policies might also be adopted by ASIC and other enforcement agencies. If an immunity policy is necessary and desirable to help detect and deter insider trading or market manipulation, the opportunity to introduce such a policy is likely to arise soon.

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Thanks are due to Caron Beaton-Wells for comments on my initial notes and to others for helpful comments on the relevant background. The usual disclaimers apply.