Australian Securities Commission v Nomura PLC
(1998) 89 FCR 301; 160 ALR 246

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Introduction

In this case, The Australian Securities Commission (ASIC) brought proceedings against Nomura International PLC, a securities company incorporated in the United Kingdom which was trading on the Australian Stock Exchange (ASX), in relation to trading activities at the ASX and the Sydney Futures Exchange (SFE). ASIC alleged that on 29 March 1996, Nomura had engaged in activities which contravened the *Corporations Law* and the *Trade Practices Act* (1974) (Cth). Justice Sackville held, on 10 December 1998, that Nomura contravened section 998 (1) and (3) of the *Corporations Law* when it cross-traded in low volume shares in order to reduce the market price for those shares on the date that its future contracts on them expired.

The Facts

Nomura put in place a number of strategies designed to capture profit from its arbitrage position in Share Price Index (SPI) futures, and realised a profit during trading on 29 March 1996, although the strategy was only partially effective. On 26 March 1996, Nomura placed orders to sell securities worth $600 million during the final 30 minutes of ASX trading. These orders were intended to unwind Nomura's SPI contracts arbitrage position. A degree of planning went into the organising and execution of the strategies, and included London Stock Exchange participation. Brokers were instructed to trade large volumes of securities with little concern for drops in price. The price of some of the securities was then seen to drop. In two cases, Nomura bought its own securities at a discounted price.

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The Legislative Framework

Section 998 of the *Corporations Law*, which is in *Part 7.11: Conduct in Relation to Securities*, deals with false trading and market rigging transactions. Specifically, s998(1) prohibits the creation of a false or misleading appearance of active trading in any securities, or the creation of a false or misleading appearance with respect to the market for, or price of , any securities.[1] Section 998(3) prohibits the causing of price fluctuations by means of dealing in securities without a change in beneficial ownership.[2]

It is significant that ASIC alleged contravention by Nomura of s998(1) & (3) of the *Corporations Law.* Section 998 is derived essentially from earlier legislation; s70 of the *Security Industry Act* 1970 (NSW), considered by the High Court in *North v Marra Developments Ltd* (1981) 37 ALR 341, 148 CLR 42.[3] In *North v Marra Developments*, which was followed in the present case, Justice Mason observed that "the object of the section is to protect the market for securities against activities which will result in artificial or managed manipulation".[4] The difficulties formerly experienced in proving alleged cases of false trading and market rigging meant that few cases were successfully prosecuted, and in contrast with s997 (which deals with substantive manipulation of the stock market and the contravention of which was not alleged), the wording of s998 (1) deals with the creation of a false or misleading appearance. It prohibits any activity which is intended to or likely to create a false or misleading appearance of active trading "in any securities". The wording of s998 (3) prohibits the causing of price fluctuation by means of any sales of purchase which do not involve a change in the beneficial ownership of those securities.

The Issues

ASIC alleged that Nomura's conduct in relation to the placement of its strategy, namely, the March Sale Order, Bid Basket, London Side Sell Order, and the London Offer Side Sell Order, had contravened, among other regulatory restrictions, ss998 (1), (3) and 1260 (1)(b) of the *Corporations Law*, and also that the Ask Basket had contravened s52 (1) of the *Trade Practices Act.* Because the ASX keeps a complete record of all orders placed and transactions carried out, there was no real dispute that Nomura had placed the orders alleged, and carried out the trading activities as a result of those orders.

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1 P.Lipton, *Essential Corporations Legislation*, LBC, 1999, at 409
2 P.Lipton, *Essential Corporations Legislation*, LBC, 1999, at 409
3 H.Ford, *Ford's Principles of Corporations Law*, Butterworths, 1999, at 1073
4 R. Tomasic, et al, *Corporations Law in Australia*, Sydney: The Federation Press, 1995, at 689

However, there was argument about the meaning of 'intended', 'any securities', and 'likely', part of the wording of s998 of the *Corporations Law*. Furthermore, even though a number of relevant telephone conversations between Nomura staff members, and between Nomura staff members and third parties, including brokers operating on the ASX, were tape recorded and the *verbatim* transcripts admitted into evidence, there was argument between the parties regarding the intentions of Nomura's senior staff in relation to the company's strategy and to the sell and buy orders given to brokers.

Nomura also argued that there were commercial realities behind its actions, and that it was merely trying to unwind an arbitrage position. Arbitrage is the art of taking advantage of price differences in different markets by buying and selling identical securities at the same time, or simply taking advantage of different rates or prices in different markets.[5]

The arbitrageur unwinds a futures position prior to expiry of the contracts by selling the stock it holds which are covered by the contracts, and acquiring a bought position in SPI contracts, thus cancelling out the sold position. If the SPI contracts price has fallen below a fair value, the unwinding can be very profitable.

Nomura also argued that its 'self trades' were 'real transactions', and that any buyer was able to take up the offers which were made.

The Decision

After hearing the arguments, His Honour Justice Sackville concluded that Nomura had engaged in conduct likely to create a false or misleading appearance of active trading on the ASX in illiquid securities held by it on 29 March 1996. It also engaged in conduct likely to create false or misleading appearance with respect to the price of illiquid securities held by it on the same day. Nomura's conduct therefore contravened the third limb of s998 (1) of the *Corporation Law*, which prohibits any activity likely to create a false appearance. Although Nomura had argued that while it was 'price insensitive', nevertheless it was merely trying to unwind it arbitrage position, His Honour found that Nomura was not in fact a price-insensitive seller of securities but that it wished to realise a profit from its arbitrage position. However, (unfortunately for Nomura) the strategies used, including the Bid Basket and the March Sale Orders, were intended to lower the price of securities included in the *All Ordinaries* at the close of trading on 29 March 1996. It intended to bring this about, in part, by self-trades at depressed prices.

The judgment reached the following conclusions on the principal legal questions in the case:

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[5] R.Bennetts, *The Australian Stock Market*, ABC Books, 1999, at 220.

(i) In two instances, by the combined operation of the March Sale Orders and the Bid Basket, Nomura both sold and purchased securities in a manner that involved no charge of beneficial ownership. It thereby contravened s998 (1) of the *Corporations Law.* It also contravened s998 (3) of the *Corporations Law.*

(ii) Nomura, in placing the Bid Basket and giving instructions for the March Sale Orders, engaged in conduct intended to create a false and misleading appearance of active trading on the ASX in illiquid securities held by it on 29 March 1996. It also engaged in conduct intended to create a false or misleading appearance with respect to the price of the illiquid securities held by it on the same day. Nomura's conduct in this respect contravened s998 (1) of the *Corporations Law.*

Some Comments

The reputation of stock traders has taken a turn for the worse since the dishonesty of traders like Ivan Boesky (who coined the well known 1980s phrase "Greed is Good") and junk bond king Michael Milliken came to light. Descriptions of ethically suspect sales to unsuspecting investors such as: ...the firm was attempting to sell the bonds of a drug-store chain... which later went bankrupt and defaulted on those very bonds. The voice boomed out of the box: "C'mon people, we're not selling truth!"[6] in books like Michael Lewis' *Liar's Poker* made it easy to believe that a group of money-hungry share traders would connive to manipulate the market to their own benefit.

Although what Nomura did was not only illegal but also immoral, I am less inclined to condemn Nomura out of hand. In the highly pressured world of securities trading, traders may find it easier to prioritise narrowly defined ideas of 'success' ahead of more abstract notions such as adherence to the law, and the need to retain ethical purity. There is also the fact that, even with carefully thought-out strategies in place, traders are often forced to think and act quickly and under enormous pressure. The complexity of the *Corporation Law* with respect to trading may also have contributed to the problem. The requirements for becoming a trader or broker are more concerned with the ability to make money for the firm than familiarity with the relevant sections of the *Corporations Law*, and this problem is compounded in cases such as this, where an international trading team move into an unfamiliar jurisdiction. While lawyers may think it worth the read, traders without a legal background may find the *Corporations Law* too much trouble, trusting in doing what they have

[6] M.Lewis, *Liar's Poker: Two Cities, True Greed,* Hodder & Stoughton, 1990, at 72

always done to steer the clear of any regulatory troubles.[7]

Furthermore, His Honour even referred obliquely to this possibility:

> "Mr Channon is clearly an extremely intelligent person who, at the relevant times, was a very successful trader. This success at trading was not, however, always matched by attention to detail. I refer elsewhere to his failure to ascertain the precise manner in which the All Ords – the index at the heart of Nomura's Australian trading activities – was calculated and his explanation for that failure. More significant for present purposes is his failure to inquire about or learn of ASX Rule 2.8 (2), which prohibited a broker from placing an order for the purchase or sale of securities the execution of which would involve no change of beneficial ownership."[8]

While not condoning what occurred, I also wonder if there could be another partial mitigation for Nomura's actions. Could cultural influences have muddied the ethical waters? Although the respondent in these proceedings was incorporated in the United Kingdom, Nomura began operations as a securities company in Japan. There is evidence to suggest significant Japanese cultural influence within the international branches of Nomura. Japanese attitudes towards legal matters differ from Australian ideas in several respects. While I am certainly not suggesting that Japanese are less likely to uphold the law, there are indications that Japanese attitudes to adhering to the strict letter of the law are more flexible than ours. As an example, "[t]he right...",[9] while honouring (sic) an agreement is not, in terms of social morality, given that high a priority".[10] Despite many years of interaction with the West, for the majority of Japanese, 'Western legal concepts still remain essentially alien – chiefly because Japanese are far more relativistic than Westerners both in personal and in group dealings'. [11]

Given a degree perhaps of implicit pressure within Nomura to toe the company line, is it not possible that staff were "persuaded by their Japanese counterparts to resolve any issues at the 'business' level, seen as distinct from a 'legal' level".[12] Although this case involved an arbitrage position, there is also a possibility that the Japanese custom of cross trading awareness of Nomura staff somewhat to some of the trading

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7 Pierpont probably should have read the section long ere this but you all know how it is with the *Companies Act* [*Corporations Law*]: you open it all agog at the prospect of a fascinating cast and an exciting plot but, somewhere around the definitions clause, the first fine careless rapture wears off and you begin wondering whether you might not be better occupied mowing the lawn or feeding the budgerigar...
T Sykes, *Vintage Pierpont*, Information Australian Group, 1985, 138.

8 ASC v Nomura International PLC [1998] 1570 FCA, December, 1998.

9 P.Samuel, "From Sweet to Sour Relations", (19 February 1972) *The Bulletin*, 53, quoted in: V Taylor, *Asian Law Through Australian Eyes*, LBC, 1997, at 318.

10 E Hoshino, (J Jaley, tras) "The Contemporary Contract", (1972) 5 *Law in Japan* 1, quoted in: V Taylor, *Asian Law Through Australian Eyes*, LBC, 1997, at 322.

11 R. Christopher, *The Japanese Mind*, Fawcett Columbine, 1983 at 167.

12 V Taylor, *Asian Law Through Australian Eyes*, LBC, 1997, 326.

restrictions within Australia's legal environment. While 'Baikai' is defined simply as "cross trading" in most Japanese financial dictionaries, an explanatory rider for the benefit of Japanese readers in *The Trend Dictionary of Current Terms* appends the following information:

> *Baikai: A trading custom unique to Japan in which a securities company, in order to generate identical numbers of buy and sell orders for the same stock, issues inquiries at prices more favourable than the order prices, and can arrange its own trading if there are no responses from other traders. It is carried out with large scale buying and selling of shares. (*my translation)[13]

Nomura alleged that, in implementing the Ask Basket and other strategies, it was merely acting as an index arbitrageur, legitimately endeavouring to realise profits from the unwinding of the complex and sophisticated arbitrage position it had established. Nomura contended that the sale of these securities in this manner was an inevitable consequence of unwinding the arbitrage position it had established.

[13] M Matsumoto, *The Trend, Japanese-English Dictionary of Current Terms*, Shogakukan, 1990, 165.