

Introduction

[1] The Financial Markets Authority (FMA) says Mr Henry engaged in market manipulation. The FMA seeks declarations that Mr Henry contravened the provisions of the Securities Markets Act 1988 (the Act) and a pecuniary penalty.

Background – parties

[2] Mr Henry was formerly the Chief Executive Officer and director of Diligent Board Member Services, Inc (Diligent). Prior to the transactions in issue Mr Henry resigned from both positions but he and his wife, Ms Borg, were trustees and beneficiaries of the B Henry & K Borg Living Trust (the Trust) which continued to hold shares in Diligent. Mr Henry and his wife were substantial security holders of Diligent shares as defined by s 21 of the Act.

[3] Diligent is a software company. It specialises in digital board books. On 12 December 2007 Diligent's common stock listed on the New Zealand Stock Exchange (NZSX) and Diligent became a public issuer within the meaning of s 2 of the Act, with its stock included in the NZX SciTech and NZX All indices.

[4] From April 2009 Mr Henry bought and sold Diligent shares from time to time through McDouall Stuart Securities Limited (McDouall Stuart), ASB Securities Limited (ASB) and Direct Broking Limited (Direct Broking). Both ASB and Direct Broking provided online share trading platforms which enabled clients direct access to the NZX trading system.

Background – FMA claims

[5] The parties have agreed a summary of facts. The summary discloses the following trading by Mr Henry in breach of the Act.

Presumptive false or misleading appearance of trades – 14 April 2010

[6] On or about 14 April 2010 Mr Henry was a party to trading in shares of Diligent from which no change in beneficial ownership resulted (the 14 April trade) specifically:

- (a) at or around 1.55 pm Mr Henry entered a new offer in the market to sell 10,000 Diligent shares at 55 cents each;
- (b) at around 2.05 pm Mr Henry entered a bid in the market to buy 5,000 Diligent shares at 55 cents each;
- (c) this resulted in the Trust buying 5,000 of its own Diligent shares at 55 cents;
- (d) the trade restored the last traded price from 50 cents to 55 cents.

[7] As a result of the 14 April trade, which was the last trade of the day, Mr Henry set the market closing price of Diligent shares, moving the closing price from 50 cents to 55 cents. Because Mr Henry was a party to trading in shares of Diligent from which no change in beneficial ownership resulted, his trading amounted to market manipulation.

Presumptive false or misleading appearance of trading – 27 April 2010

[8] On or about 27 April 2010 Mr Henry was again a party to trading in shares of Diligent from which no change in beneficial ownership resulted (the 27 April trade).

[9] Between 10.28 am and 10.34 am on 27 April 2010 Mr Henry purchased 22,000 Diligent shares at 61 cents in three separate trades.

[10] Between 11.46 am and 11.59 am on 27 April 2010 Mr Henry sold 23,000 Diligent shares at 62 cents in two separate trades.

[11] At around 10.35 am Mr Henry entered a bid to buy 10,000 Diligent shares at market. A trade occurred which resulted in the Trust buying 8,000 Diligent shares at

61 cents each from an independent seller and 2,000 of its own Diligent shares at 62 cents each.

[12] The remaining Diligent shares that Mr Henry was offering at 62 cents became the best offer in the market. The purchase of 2,000 of its own Diligent shares at 62 cents each was the first trade in the market at the price that day. The trading amounted to market manipulation.

[13] Following Mr Henry's actions on 27 April 2010 Mr Lister, the Manager at ASB, had a telephone conversation with Mr Henry during which:

- (a) Mr Lister warned Mr Henry about market manipulation, in particular that:
 - (i) Mr Henry was not allowed to buy and sell to himself;
 - (ii) As a net seller of Diligent shares, Mr Henry should not buy small amounts of shares in order to increase the price of the shares; and
 - (iii) Mr Henry should not concern himself with trying to control the liquidity of Diligent shares or with trying to control its opening or closing price.
- (b) Mr Lister encouraged Mr Henry to consult the securities commission's website for guidance on market manipulation rules;
- (c) Mr Henry stated that he was a net seller of Diligent shares;
- (d) Mr Henry confirmed he knew that he was not allowed to buy and sell to himself; and
- (e) Mr Henry stated he would seek advice about his trading.

[14] On or about 29 April 2010 ASB unilaterally closed the Trust's share trading account due to concerns it held about Mr Henry's share trading.

False or misleading appearance of trading – 20 April 2010

[15] In earlier trades Mr Henry had also placed a number of buy and sell orders in Diligent shares and traded in Diligent shares. On 20 April 2010 Mr Henry first sold Diligent shares at 57 cents, then sold Diligent shares at 56 cents, then bought Diligent shares at 57 cents (the 20 April trades). In doing so Mr Henry:

- (a) artificially inflated the Diligent share price by layering bids and offers in the market;
- (b) gave an artificial impression of the level of trading interest in Diligent shares;
- (c) forced other buyers and sellers to bid at higher prices in order to trade; and
- (d) set the market closing price.

[16] The 20 April trades did not reflect the forces of genuine supply and demand in the market and amounted to market manipulation.

False or misleading appearance of trading – 23 April 2010

[17] On or about 23 April 2010 Mr Henry had also placed a number of buy and sell orders in Diligent shares and traded in Diligent shares (the 23 April trades).

[18] As a result of Mr Henry's actions on 23 April, the closing price of Diligent shares was 60 cents, which was set by Mr Henry's trade at 4.59 pm. When the market closed, the difference between the highest bid price and the lowest offer price (the spread) was 2 cents (bid 59 cents and offer 61 cents).

[19] Mr Henry placed both buy and sell orders in the market and withdrew his buy orders once the market had moved in his favour and other buyers had traded with his sell orders. In making the 23 April trades, Mr Henry:

- (a) artificially inflated the Diligent share price by layering bids and offers in the market;
- (b) gave an artificial impression of the level of trading interest in Diligent;
- (c) forced other buyers to bid at higher prices in order to trade; and
- (d) set the market closing price of Diligent shares.

[20] Mr Henry's trading on 23 April amounted to market manipulation.

False or misleading appearance of trading – 21 May 2010

[21] On or about 21 May 2010 Mr Henry placed a number of buy and sell orders in Diligent shares and traded in Diligent shares (the 21 May 2010 trades). In making the 21 May trades Mr Henry:

- (a) Artificially inflated the Diligent share price by layering bids and offers in the market;
- (b) gave an artificial impression of the level of trading interest in Diligent; and
- (c) forced another buyer to bid at a price higher than 62 cents in order to trade.

[22] The 21 May trades had, or were likely to have, the effect of creating, or causing the creation of, a false or misleading appearance:

- (a) with respect to the extent of active trading in Diligent shares; or

- (b) with respect to the supply of or demand for price for trading in, or value of Diligent shares

so that Mr Henry's trading on 21 May amounted to market manipulation.

False or misleading appearance of trading – 14 June 2010

[23] On or about 14 June 2010 Mr Henry placed a number of buy and sell orders in Diligent shares and traded in Diligent shares (the 14 June trades). Mr Henry first sold Diligent shares at 66 cents each then entered a bid to buy shares at 67 cents each. As such the 14 June trades did not reflect the forces of genuine supply and demand in the market. The 14 June trades in which Mr Henry layered buy and sell orders on both sides of the market, gave an artificial impression of the level of trading interest in Diligent shares.

[24] The 14 June trades had, or were likely to have, the effect of creating or causing the creation of a false or misleading appearance with respect to the extent of active trading in Diligent or with respect to the supply of, demand for, price for trading in, or value of Diligent shares and thus amounted to market manipulation.

[25] As a result of communications with ASB Mr Henry telephoned and emailed the Securities Commission on 14, 15 and 29 April 2010. Mr Henry says he also did so on 3 May 2010.

[26] I record the above admissions are made under s 9 of the Evidence Act 2006 for the purposes of resolution of this proceeding only and are not evidence of any fact, matter or thing in any other proceeding.

Market manipulation

[27] Mr Henry's admitted conduct was market manipulation in breach of s 11B of the Act. A presumption of contravention applies to the trading on 14 and 27 April 2010 as Mr Henry was a party to trading in Diligent's shares from which no change in beneficial ownership resulted,¹ They were "wash sales" as they are colloquially

¹ Section 11C.

known as. Further, Mr Henry ought reasonably to have known that his actions would have, or would be likely to have, the effect of creating, or causing the creation of, a false or misleading appearance with respect to the extent of active trading in Diligent's shares or with respect to the supply, demand, price or value of Diligent's shares.²

Declaration of contravention

[28] Mr Henry's actions contravened a civil remedy provision as defined in s 42S of the Act. The FMA is entitled to a declaration of contravention from this Court that Mr Henry has breached the prohibition against market manipulation by engaging in the conduct and trades described in paras [6]–[24] above in relation to Diligent.³ I declare accordingly.

Is a pecuniary penalty appropriate?

[29] Having made that declaration of contravention the Court may order Mr Henry to pay a pecuniary penalty it considers appropriate if satisfied that, in this case, the contravention is likely to materially damage the integrity or reputation of any of New Zealand's security markets.⁴

[30] Prior to its enactment the then Minister of Commerce explained the need for the Act as follows:⁵

8. The term market manipulation refers to practices involving the creation of a false impression of securities trading activity or price movement or market information. Market manipulation undermines the market efficiency through distorting prices and results in an inefficient allocation of resources. Regimes regulating market manipulation are found in nearly all major foreign jurisdictions.

...

12. It is important for New Zealand to satisfy international investors (and domestic investors) that our financial markets have integrity and meet international standards.

...

² Securities Markets Act 1988, s 11B.

³ Section 42V.

⁴ Section 42T(1)(c)(iii).

⁵ "Review of Securities Trading Law: Market Manipulation", 24 July 2003 Cabinet Paper.

[31] In *Re De Gouveia* the Alberta Securities Commission noted the effect of market manipulation as follows:⁶

[27] Gouveia's misconduct was serious. As we stated in the Merits Decision:

- The capital market is the forum in which market participants can implement investment decisions founded on their respective understandings and assessments of the information available. Indications that another, or multiple other, market participants are interested in buying or selling a particular security at a particular time, at a particular price and in a particular volume will form a part – a potentially crucial part – of the informational backdrop to trading and investment decisions, and thus to the operation of the market as a whole.

[28] Manipulative trading, such as Gouveia engaged in, thus undermines the integrity of the capital market. It is unfair to investors, and jeopardizes the confidence in the capital market on which legitimate investor interest and capital formation depend.

[32] The conduct that Mr Henry engaged in undermines the development of a fair, efficient, and transparent financial market. Such market manipulation is likely to undermine the integrity of the NZX and jeopardise the confidence of both overseas and domestic investors in the NZ security markets. A pecuniary penalty is appropriate.

Assessment of the penalty

[33] As noted, the case comes before the Court on a consent basis, at least to the extent that Mr Henry accepts his conduct amounts to market manipulation as noted in the summary of facts and is in breach of the Act. He also accepts that a pecuniary penalty is appropriate. With counsels' assistance the FMA and Mr Henry suggest the appropriate penalty is \$130,000 in this case. That figure is reached after adopting a starting point of \$190,000 – \$200,000 and then taking account of mitigating factors.

[34] I understand from counsel that this is the first case of a pecuniary penalty being imposed under the Act. I agree with their submission that the Court can properly adopt a similar approach to that taken in relation to the imposition of

⁶ *Re De Gouveia* 2013 ABASC 249.

penalties for breaches of the Commerce Act 1986.⁷ The relevant provisions of both Acts are directed at the regulation of the relevant markets.

[35] There can be no objection to a joint view of the parties as to the appropriate penalty nor to such a view being reached as a result of negotiations so that it represents what can properly be described as a settlement. Such settlements are in the interests of the parties and the community in general as they enable an early disposal of the proceedings. They encourage a realistic view of culpability and penalty.⁸

[36] Further, applying the observations of Rodney Hansen J in *Commerce Commission v Alstom Holdings SA* to the present case:⁹

... there is a significant public benefit when [a person such as Mr Henry] acknowledge[s] wrongdoing, thereby avoiding time-consuming and costly [investigation and] litigation. The Court should play its part in promoting such resolutions by accepting a penalty within the proposed range. [A person such as Mr Henry] should not be deterred from a negotiated resolution by fears that a settlement will be rejected on insubstantial grounds or because the proposed penalty does not precisely coincide with the penalty the Court might have imposed.

[37] I start with the maximum available penalty. Section 42W of the Act provides the maximum penalty is the greater of:

- (a) the consideration for the transaction constituting the contravention; or
- (b) three times the amount of the gain made or the loss avoided by Mr Henry in carrying out the conduct; or
- (c) \$1 million.

⁷ I note that s 80 of the Commerce Act provides the Court must impose a pecuniary penalty unless there is good reason for not making that order, whereas under s 42T(1)(c) this Court has a discretion whether to order a pecuniary penalty but otherwise there is a similarity between the structure of the relevant provisions in the way they provide for a maximum penalty. Each Act also provides for factors that the Court must have regard to in fixing the appropriate penalty.

⁸ *Commerce Commission v New Zealand Milk Corporation Ltd* [1994] 2 NZLR 730; and *Commerce Commission v Air New Zealand Ltd* [2013] NZHC 1414 at [23].

⁹ *Commerce Commission v Alstom Holdings SA* [2009] NZCCLR 22 at [18].

[38] In this case s 42W(1)(a) and (b) are not directly applicable. To the extent there are any gains made by Mr Henry they were minimal. The total consideration for the transactions in issue is substantially under \$1 million in each case. In cases of market manipulation of this kind it is likely the maximum penalty will be \$1 million as it is in the present case. However, that maximum applies to each of the six instances of market manipulation. The maximum penalty available is \$6 million.

[39] In determining the appropriate pecuniary penalty the Court must have regard to all relevant matters, including:

- (a) any purpose or criteria stated in the Act applying to the civil remedy provision;
- (b) the nature and extent of the contravention;
- (c) the likely nature and extent of any damage to the integrity or reputation of any New Zealand's securities markets because of the contravention; and
- (d) the nature and extent of any loss or damage suffered by a person, or gains or losses avoided by the person in contravention;
- (e) the circumstances in which the contravention took place;
- (f) whether or not Mr Henry has previously been found by the Court in proceedings under the Act to have engaged in similar conduct;
- (g) the relationship of the parties to the transaction constituting the contravention.¹⁰

¹⁰ Section 42Y.

Purpose or criteria stated in the Act

[40] Section 42T(1)(c)(iii) supports the imposition of a pecuniary penalty because, as noted, Mr Henry's actions are likely to materially damage the integrity or reputation of New Zealand's security markets.

The nature and extent of the contravention

[41] Mr Henry's offending conduct took place over a period of approximately two months from 14 April until 14 June 2010. The 14 April and 27 April trades involved wash trades and were presumptively in contravention of s11B. The trades on 20 April, 23 April, 21 May and 14 June involved layering and narrowing of the spread. Overall, Mr Henry's trading gave an artificial impression of the level of interest in Diligent shares. Mr Henry apparently saw himself as an amateur "market maker" providing support and liquidity for Diligent's stock. However, he ought to have known that his trading was likely to give a misleading appearance of the demand for Diligent shares.

[42] While Mr Henry made no discernible profit, s 42W confirms that even if there is no gain made nor loss avoided the maximum penalty is still \$1 million.

[43] Mr Henry was in a position of dominance and control over the trading in Diligent shares. Although no longer a director of Diligent, through the Trust he was a substantial shareholder in Diligent. Mr Henry's trading in Diligent was significant. As a percentage of the trading in Diligent shares during the relevant period Mr Henry's trades accounted for: April: 38.19%; May: 16.18%; June: 22.96%.

The likely nature and extent of damage to the integrity or reputation of the New Zealand Securities Markets

[44] For the reasons given in the case of *Re De Gouveia* the offending has the potential to adversely affect confidence in the New Zealand market.

The nature and extent of any loss or damage suffered by a person or gains or losses avoided

[45] As noted, Mr Henry and his interests did not gain materially out of the trading in issue. The FMA argues other traders were forced to trade at higher prices by Mr Henry's conduct and therefore must be taken to have suffered a loss. But there is no direct evidence of any loss or damage suffered by other persons. Also, as Mr Billington QC pointed out, the Diligent share price is now significantly in excess of the range in which it traded during mid 2010 when the offending conduct occurred.

Circumstances in which the contravention took place

[46] While Mr Henry's actions in themselves were deliberate, he did not deliberately set out to breach the Act. It is acknowledged his liability arises because he "ought to have been aware" that what he was doing was a breach.

[47] There is also some debate between the FMA and Mr Henry as to whether he "self-reported" to the Securities Commission or not. Mr Billington submitted that when Mr Henry became aware of the first "errant" trade he called and emailed Mr Graham Denver-Fedder and his immediate superior at the Securities Commission, John Mulry. Mr Billington referred to an email of 29 April Mr Henry had sent to Mr Graham Denver-Fedder. When it was returned he sent a copy to Mr Mulry.

[48] In response Mr Williams referred to an earlier email exchange with the Commission following the first presumptive trade on 14 April 2010. The exchange in the emails of 15 April is somewhat equivocal. It is apparent from the emails that Mr Henry left a phone message with the Securities Commission on 14 April. When asked for further details Mr Henry advised the Commissioner's officer that:

I don't think it's a big deal ... I spoke with the ASB and basically, they said "bad luck – be more careful".

What happened was I was trying to adjust an existing SELL order – to sell more shares at .55 cents – then when I clicked "update" on the ASB on-line site – something weird happened on the internet, and my adjustment to my existing SELL at .55 cents became a SELL at market – rather than SELL at .55 cents.

The mistake cost me about \$460. Lesson learnt, be super careful when trading on line.

The matter was left on that basis. However, Mr Henry's explanation does not directly address the trading which occurred at 1.55 pm on 14 April which was the presumptively false trading. The email is more directly related to the sale by the Trust of Diligent shares at 51 and 50 cents each when Mr Henry (apparently mistakenly) amended his existing order to sell from 55 to market.

[49] Overall, however, I accept Mr Henry's communications with the ASB and the Commission disclose that he was open about his trading.

Relationship of the parties to the transaction

[50] As noted, Mr Henry was a substantial shareholder of Diligent through the Trust.

[51] Having regard to the above factors and before considering personal and other mitigating factors I consider the breaches in the present case would support a penalty towards the lower end of the scale. Recognising the maximum in each case is \$1 million and the importance of preserving the markets' integrity and reputation, each contravention, taken on its own, would support a starting point for penalty of between \$40,000 to \$50,000 (i.e. 4% to 5% of the maximum). Cumulatively that would lead to a starting penalty in the range of \$240,000 to \$300,000. However, having regard to the totality principle I accept that a starting point for penalty of \$200,000 is appropriate for the offending taken overall.

[52] There are no personal aggravating factors that support an uplift from that starting point.

[53] I turn to mitigating factors.

Previous conduct

[54] Mr Henry has not previously been found to have engaged in similar conduct or conduct in breach of the Act. While Mr Henry is a sophisticated businessman and

capital raiser, at the time of this trading in 2010 he was not a professional or regular online trader of stocks. Mr Billington submitted Mr Henry acted as he did to provide support and liquidity for Diligent's stock because he considered the true value of the stock was suppressed by the media publicity that had surrounded his resignation at the time the company was listed.

[55] The length of time that passed during the investigation and subsequent issue of the proceedings is also relevant. Under s 42ZJ proceedings must be issued within three years after the date on which the matter giving rise to the contravention was discovered (or ought reasonably to have been discovered).¹¹ The proceedings were not issued until 13 June 2013. Mr Henry had applied to strike out these proceedings on the basis they were issued out of time. Mr Billington submitted the NZX was aware of the breach before 13 June 2010 and was under an obligation to notify the Commission (under s 36ZD). Mr Henry has chosen not to pursue that strike out argument. Mr Williams does not accept the argument had merit. While the Markets Supervision branch of the NZX opened an investigation into Mr Henry's trading on 27 April 2010, it did not report to the Commission under s 36ZD until 14 June 2010. However, the matter was not determined and I accept Mr Billington's submission there was at the least a "respectable argument" which has been conceded in confirming the agreed statement of facts and accepting a penalty is appropriate. I take that into account in Mr Henry's favour. I consider that it balances out the fact that his acknowledgement of wrongdoing came quite late in the piece and well after the issue of the proceedings.

[56] In the circumstances I accept that a total deduction in the range of 30 to 40% from the starting point is appropriate to take account of mitigating factors and Mr Henry's acknowledgement of wrongdoing. That would support a penalty in the range of between \$120,000 and \$140,000. The \$130,000 penalty proposed falls within that range.

Result/orders

[57] I confirm and approve the penalty at \$130,000.

¹¹ As inserted by Securities Markets Amendment Act 2006.

[58] I make an order pursuant to s 42Z of the Act that the penalty is to be applied first to pay the FMA's actual costs in bringing these proceedings,.

Venning J