MARKET MANIPULATION ANNOTATED BIBLIOGRAPHY

Prepared by Sarah Dunn Davis
Post-Doctorial Research Fellow
Columbia Law School/Business School Program in the Law and Economics of Capital Markets
Updated as of June 24, 2010

1. Federal Statutes and Regulations, Legislative History, and Proposed Legislation

Statutes & Regulations


(Westlaw link, log-in required – click here)

1. Specific Prohibitions of the 34 Act’s § 9(a)
   a. Overall note: Sections 9(a)(1) and (2) deal with manipulative trading practices, while 9(a)(3)-(5) deal with information-based manipulative schemes
   b. As compared with other anti-manipulation provisions: these apply to manipulative activity on national securities exchanges. But this does “not preclude exchange registered securities by means of illegal manipulative practices effectuated in the over-the-counter markets. This was recognized in an early case, In re Wright.” (See Lowenfels article on Section 9, below, p.706)
   c. Statutory Provisions, broken down
      i. 9(a)(1) Wash sales and matched orders are unlawful. Here the same person or affiliate is on both sides of transaction
      ii. 9(a)(2) catchall makes it unlawful to effect transactions on exchanges for purpose of inducing purchase or sale of security
      iii. 9(a)(4) Prohibits brokers, dealers, others offering or selling security from making statements they know/should know to be false/misleading for purpose of inducing purchase or sale of security (Compare with Rule 10b-5 standard which is not this negligence standard, but requires intentional conduct)
      iv. 9(e) express private right of action for victims (anyone who purchased security at price affected by conduct) to sue those who violate 9(a)
         1. Mental state requirement is “willful”—private suits may only be brought for willful violations of Sections 9(a)-(c)
         2. In order for private claim to survive, plaintiff must show he is a purchaser/seller of manipulated security who transacted in security at a price which was affected by the manipulation

2. Relevant amendment
   a. In 2000, Section 9(a) (but not 9(e)) was amended to cover securities-based swap agreements (even though these are not “securities” under the act.) 15 U.S.C. § 78i(a), as amended by Pub. Law 106-554, 114 Stat. 2763 (December 21, 2000)
i. Amendment was part of legislative actions redistributing jurisdiction between the SEC and CFTC for swaps. (see Hazen treatise, below, Chapter 12, footnote 9)
Exchange Act – Section 10(b), 15 U.S.C. § 78j(b)
(Westlaw link, log-in required – click here)
Section 10(b) supplements specific statutory scheme of § 9 and gives SEC authority to proscribe (with interstate commerce predicate) any manipulative device or contrivance in connection with the purchase or sale of ANY security (does not have to be traded on an exchange)

Rule 10b-1, 17 C.F.R. § 240.10b-1
(Westlaw link, log-in required – click here)
Extends prohibitions in Section 9(a) to securities exempt from Section 12’s registration requirements.

Rule 10b-5, 17 C.F.R. § 240.10b-5
(Westlaw link, log-in required – click here)
Overall note: just as with Section 9, you can break the provisions down into trade-based (clauses (a) and (c)) and information-based (clause (b)) anti-manipulation rules. See United States v. Charnay case, below, where Ninth Circuit describes how trade-based manipulation violates clauses (a) and (c) because there was manipulative conduct, and no misstatements/omissions.

Clause (a): manipulative conduct as a device, scheme, or artifice to defraud
Clause (b): as an omission of a material fact necessary to make statement not misleading under the circumstances
Clause (c): an act, practice, or course of business which operates as a fraud/deceit

Rule 10b-18, 17 C.F.R. § 240.10b-18
(Westlaw link, log-in required – click here)
Exception to Rule 9(a)(2) and Section 10(b)/Rule 10b-5. Safe harbor applicable to issuer repurchase programs. Programs do not violate the rules if, with technical exceptions, 4 conditions are met. Non-compliance does not raise presumption of violation of Section 9(a)(2) or Rule 10b-5.

Exchange Act § 14(e), 15 U.S.C. § 78n(b)
(Westlaw link, log-in required – click here)
Market manipulation in connection with tender offers.

Rule 14e-5, 17 C.F.R. § 240.14e-5
(Westlaw link, log-in required – click here)
Prohibits purchases by persons making a tender offer unless it is done in accordance with terms of tender offer.

Rule 14e-8, 17 C.F.R. § 240.14e-8
(Westlaw link, log-in required – click here)
Rule 14e-8 makes it a manipulative device “for any person to publicly announce that the person (or party on whose behalf the person is acting) plans to make a tender offer that has not yet been commenced, if the person ...”

Registered (with SEC) broker-dealers must belong either to a national securities exchange or to NASD (FINRA) (invokes SRO rules).

Exchange Act § 15(c)(1)-(2), 17 U.S.C. § 78o(c)(1)-(2), and Rule 15c1-2, 17 C.F.R. § 240.15c1-2

Manipulative practices by a broker-dealer that violate Section 9 with respect to OTC securities. Prohibits them from effecting transactions in OTC market by means of “manipulative, deceptive, or other fraudulent devices or contrivances.” No express private right of action as there is in section 9(e).

Rule 15c1-8, 17 C.F.R. § 240.15c1-8

Rule 15c1-8: “Sales at the Market” – makes it a violation of Section 15(c)(1) for broker to falsely represent that securities are offered at market price.

Rule 17a-2, 17 C.F.R. § 240.17a-2

Affirmative obligation of recordkeeping relating to stabilization activities.

Rule 17a-3, 17 C.F.R. § 240.17a-3

Record-keeping obligations for brokers and dealers. If broker/dealer charged with manipulation, usually this also is charged.

Rules 100-105, Regulation M, 17 C.F.R. § 242.100-05 (34 Act)

Rule 100 has definitions applicable to Reg M, which includes Rules 100 through 105. Rule 101 regulates bids/purchases during distribution by issuer/other distribution participants or affiliated purchasers. Rule 102 does the same for the distributer’s underwriter/prospective underwriter, broker, dealer, or other person participating in distribution. Rule 103 (“Nasdaq passive market making”) permits underwriter/dealer to continue to make market on Nasdaq in security during distribution but market maker must remain “passive,” i.e. bid or purchase cannot exceed highest independent bid for, or purchase of, covered security at time of transaction. Rule 104 permits stabilization under certain circumstances. Rule 105 is about short selling during offering period and prohibits, with certain exceptions, short selling a security that is the subject of the offering and purchasing offered securities from those participating in the distribution.

The Securities Act of 1933

Securities Act § 17(a), 15 U.S.C. § 77q

Used instead of 9(a) where requirement that securities be listed on national exchange not met, where manipulation occurs in OTC markets (used against any person who is defendant, not just broker-dealer defendants).
Repurchase Disclosure Regulations: Item 703 of Regulation S-K, 17 C.F.R. § 229.508 (and S-B, Item 15(e) of Form 20-F, Item 8 of Form N-CSR)

(Westlaw link, log-in required – click here (Item 703))

Note 2 to Rule 10b-18 discusses how regardless of whether repurchases are made within the safe harbor, issuer repurchases must report their repurchasing activity under Rule 703 of Regulations S-K and S-B (reporting issuers) and Item 15(e) of Form 20-F (foreign private issuers), and Item 8 of Form N-CSR (closed-end management investment companies under the Investment Company Act of 1940).


(Westlaw link, log-in required – click here)

Item 508(l) covers “Stabilization and Other Transactions” and requires disclosure of transactions that stabilize, maintain, affect market price. Also requires disclosure of syndicate short covering transactions and penalty bids, specifically.


(Westlaw link, log-in required – click here)

This essentially applied Section 15(c) of the 1934 act to investment advisers. It made it unlawful for advisers: (c)“to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.”

Investment Company Act of 1940, § 17(j), 15 U.S.C. § 80a-17(j)

(Westlaw link, log-in required – click here)

This section was added to the Act in 1970. It states; “It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company or any affiliated person of an investment adviser of or principal underwriter for a registered investment company, to engage in any act, practice, or course of business in connection with the purchase or sale, directly or indirectly, by such person of any security held or to be acquired by such registered investment company in contravention of such rules and regulations as the Commission may adopt to define, and prescribe means reasonably necessary to prevent, such acts, practices, or courses of business as are fraudulent, deceptive or manipulative. Such rules and regulations may include requirements for the adoption of codes of ethics by registered investment companies and investment advisers of, and principal underwriters for, such investment companies establishing such standards as are reasonably necessary to prevent such acts, practices, or courses of business.”

Legislative History (34 Act)

Section 2 of 34 Act “Necessity for Regulation” [15 U.S.C. § 78b(3) (Westlaw link, log-in required – click here)]: “(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b)
hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.”

Senate Committee Report on 34 Act: “The purpose of the Act is . . . to purge the securities exchanges of those practices which have prevented them from fulfilling their primary function of furnishing open markets for securities where supply and demand may freely meet at prices uninfluenced by manipulation or control.” United States v. Charnay, see below (Westlaw link, log-in required – click here), quoting Senate Report No. 1455, 73d Cong., 2d Sess., p. 81 (1934)

House Committee Report on 34 Act: “To insure to the multitude of investors the maintenance of fair and honest markets, manipulative practices of all kinds on national exchanges are banned. The bill seeks to give to investors markets where prices may be established by the free and honest balancing of investment demand with investment supply . . . .” HR Rep No 1383, 73d Cong, 2d Sess, 10-11 (1934) (Westlaw link, log-in required – click here);


Proposed Legislation: See also the “Law Firm Client Updates” Section. (Check online for current status)

**Over-the-Counter Derivatives Markets Act of 2009**

See description in law firm client update section, Goodwin Proctor “alert” of August 2009 (click here): “The draft legislation would explicitly make a security-based swap a “security” for purposes of federal securities laws, thereby making these instruments subject to the full panoply of regulations and rules applicable to most other securities. Likewise, security-based swaps would specifically be included for purposes of Section 13 (reporting requirements) and Section 16 (insider transactions) of the Securities Exchange Act. On the other hand, offering, selling or trading security-based swaps with non-qualified persons would be flatly prohibited absent registration and exchange listing. * * * * “Business conduct rules for registered dealers and major market participants addressing fraud, manipulation and other abusive practices would be within the joint rulemaking powers of the CFTC and SEC.”

a. Track on this website – click here
b. As of Feb. 15, 2010, last action was Oct. 15, 2009 “reported by committee”
c. Text of bill – click here
d. Based on the proposal released by the Obama Administration (the “Obama Proposal”) on August 11, 2009. Similar bill also growing out of the Obama Proposal is ““Derivatives Markets Transparency and Accountability Act of 2009”

**Derivatives Markets Transparency and Accountability Act of 2009 (the “Peterson Bill”)**

See description in law firm client update section. This could do the same as the “Over-the-Counter Derivatives Market Act of 2009.”: “Both bills would give the SEC and the CFTC expanded rulemaking and enforcement authority to prevent market manipulation, fraud and other market
abuses with respect to swaps and security-based swaps and would impose “statutory disqualification” limitations on persons associated with newly regulated entities.” - , Davis Polk Client Newsflash of August 2009 – click here.
   a. As of Feb, 23, 2010, last action was Feb, 12, 2009 “reported by Committee” track here
   b. Text of Bill – click here
   c. Based on the proposal released by the Obama Administration (the “Obama Proposal”) on August 11, 2009.

The Authorizing the Regulation of Swaps Act (the “Levin-Collins Bill”)
See description in law firm client update section: “For example, Section 5 of the Bill, which contains conforming amendments, provides that Sections 9 and 10(b) of the 1934 Act are amended by replacing “security-based swap” with “swap agreement.” The effect of this is to extend the SEC’s authority to enforce anti-manipulation and anti-fraud provisions under the 1934 Act to all swaps. Yet, there is nothing in the Bill that would make this the exclusive jurisdiction of the SEC. With the caveat that certain drafting peculiarities of the Bill (which are discussed further herein) introduce difficult interpretive issues regarding the intended scope of regulators’ authority, it would seem that the general regulatory authority granted to each regulator would permit it to promulgate its own anti-manipulation and anti-fraud provisions.” – Davis Polk, May 13, 2009. Click here
   a. As of Feb. 23, 2010, last action was “referred to committee, May, 4, 2009”
   b. Text of Bill – click here

Wall Street Reform and Consumer Protection Act of 2009
   i. Extends Section 9, which relates to market manipulation, and 10(a)(1), which relates to short sales, to cover any security “other than a government security,” rather than just securities “registered on a national securities exchange.”
   ii. Extends Section 9(b), which relates to options, to non-exchange transactions in options.
   iii. Amends Section 9(c) to subject all brokers and dealers to the provision, not just “member[s] of a national securities exchange.”
   iv. Amends Section 15(c)(1)(A) to cover exchange transactions, not just over-the-counter transactions.” – Davis Polk – click here
   a. Track on this website – click here
   c. Text of Bill – click here; amendments, click here

Investor Protection Act of 2009
(This appears to repeat the same thing as the Wall Street Reform and Consumer Protection Act of 2009). See description in law firm client update section: It “would increase the scope of the Securities Exchange Act of 1934 (the “Exchange Act”) by replacing or removing several phrases in the provisions related to market manipulation and short sales. Section 9 (relating to market
manipulation) and 10(a)(1) (relating to short sales) would be amended to cover any security “other than a government security,” as compared to the current versions of these Sections, which cover only securities “registered on a national securities exchange.” – Davis Polk. Click here

a. As of Feb. 18, 2010, the last action on this was in November 2008, when it was in committee in the House. Next step is house vote. Click here

Liability for Aiding and Abetting Securities Violations Act of 2009 (Senate Bill 1551)
A bill to amend section 20 of the Securities Exchange Act of 1934 to allow for a private civil action against a person that provides substantial assistance in violation of such Act

1. The status as of Feb. 24, 2010 was that it was last in House Judiciary Committee in September 2009
2. Track on this website – click here

Proposed Regulation: SEC’s February 2010 Proposal to Clarify and Modernize Rule 10b-18 (comments due March 2010)
Click here for a law firm client update. Asks for comment on modification of the specific requirements of the time of purchase and price conditions, an exception to the rule that failure to meet the conditions for the rule on a given day disqualifies all of the issuer’s purchases for “flickering quotes,” and a modification of the merger exclusion for special purpose acquisition companies.
2. State Statutes and Regulations

State Uniform Securities Act of 2002 (available here, which is the link you are routed to from the National Conference of Commissioners on Uniform State Law’s website here)

Section 501, a “fraud” section, tracks 10b-5 mostly (without interstate commerce predicate and 10b-5 says “in connection with the purchase or sale of any security,” and does not include “offer”): “It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

   (1) to employ a device, scheme, or artifice to defraud;
   (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it is made, not misleading; or
   (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

Official comment #5 to Section 501 says: “5. Because Section 501, like Rule 10b-5, reaches market manipulation, see 8 Louis Loss & Joel Seligman, Securities Regulation Ch.10.D (3d ed. 1991), this Act does not include the RUSA market manipulation Section 502, which had no counterpart in the 1956 Act.”

Section 509 “civil liability”

   o Section (a) notes that “Enforcement of civil liability under this section is subject to the Securities Litigation Uniform Standards Act of 1998”

Website shows it has been adopted by 18 states – click here


(Westlaw link, log-in required – click here)

This amends Section 16 of the 33 Act and Section 28 of the 34 Act to provide that any “covered class action” involving a “covered security” filed in state court is removable to federal court. It was enacted to prevent plaintiffs from filing securities cases in state court in an attempt to circumvent the Private Securities Litigation Reform Act of 1995.
3. Self-Regulatory Organization (SRO) Rules (text only)

NOTE: Click here for NASD to FINRA conversion chart

FINRA Rule 2020 (click here for rule on FINRA website; not on Westlaw)
(formerly NASD Rule 2120)
“2020. Use of Manipulative, Deceptive or Other Fraudulent Devices
No member shall effect any transaction in, or induce the purchase or sale of, any security by
means of any manipulative, deceptive or other fraudulent device or contrivance.”

FINRA Rule 2010 (click here for rule)
(formerly NASD Rule 2110)
“2010. Standards of Commercial Honor and Principles of Trade
A member, in the conduct of its business, shall observe high standards of commercial honor and
just and equitable principles of trade.”

FINRA Rule 5210 (click here for rule)
(formerly NASD Rule 3310 and IM-3310)
“5210. Publication of Transactions and Quotations
No member shall publish or circulate, or cause to be published or circulated, any notice, circular,
advertisement, newspaper article, investment service, or communication of any kind which
purports to report any transaction as a purchase or sale of any security unless such member
believes that such transaction was a bona fide purchase or sale of such security; or which
purports to quote the bid price or asked price for any security, unless such member believes that
such quotation represents a bona fide bid for, or offer of, such security.”

“Supplementary Material .01:
.01 Manipulative and Deceptive Quotations. (same page)
It shall be deemed inconsistent with Rules 2010 (Standards of Commercial Honor and Principles
of Trade), 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices) and 5210
/Publication of Transactions and Quotations) for a member to publish or circulate or cause to be
published or circulated, by any means whatsoever, any report of any securities transaction or of
any purchase or sale of any security unless such member knows or has reason to believe that
such transaction was a bona fide transaction, purchase or sale.
Similarly, it shall be deemed inconsistent with Rules 2010, 2020 and 5210 for a member, for
itself or for any other person, to publish or circulate or to cause to be published or circulated, by
any means whatsoever, any quotation for any security without having reasonable cause to believe
that such quotation is a bona fide quotation, is not fictitious and is not published or circulated or
causued to be published or circulated for any fraudulent, deceptive or manipulative purpose.
For the purposes of this Rule, the term "quotation" shall include any bid or offer or any formula,
such as "bid wanted" or "offer wanted," designed to induce any person to make or submit any bid
or offer.”

OLD NASD Rule 2710(f)(2)(J)
Limit on exercise of “Greenshoe/over-allotment option”): “Without limiting the foregoing, the
following terms and arrangements, when proposed in connection with a public offering of
securities, shall be unfair and unreasonable. . . “When proposed in connection with the
distribution of a public offering of securities on a "firm commitment" basis, any over allotment
option providing for the over allotment of more than 15% of the amount of securities being
offered, computed excluding any securities offered pursuant to the over allotment option.” On
FINRA website, it notes that this rule has been superseded: “This rule is no longer applicable.
NASD Rule 2710 has been superseded by FINRA Rules 5110 and 5190. Please consult the
appropriate FINRA Rule.” But Rule 5110 references rules being “subject to any overalottment
option” but no substantive regulation of the option, and 5190 does not mention it. See –link.
4. Cases

ATSI Communications, Inc. v. Shaar Fund, Ltd., 493 F.3d 87 (2d Cir. 2007). – (Westlaw link, log-in required – click here)

Court of Appeals affirmed district court’s dismissal of this case in which corporation-plaintiffs sued investor defendants who allegedly defrauded them into selling convertible securities to entities owned by them. Manipulation claims were made in the context of Rule 10b-5. Plaintiffs alleged defendants engaged in a “death spiral” manipulation scheme: “The shareholder would short sell the victim's common stock to drive down its price. He then converts his convertible securities into common stock and uses that common stock to cover his short position. The convertible securities allow a manipulator to increase his profits by allowing him to cover with discounted common shares not obtained on the open market, to rely on the convertible securities as a hedge against the risk of loss, and to dilute existing common shares, resulting in a further decline in stock price.” (at 96). Court held that manipulation was insufficiently pled under more specific pleading standard of FRCP 9(b). (at 103). Plaintiffs did not show any connection between defendant’s actions and price response. (at 103-04). Plaintiffs also specifically made insufficient pleadings with respect to scienter because their argument was that a legitimate investment vehicle created an opportunity for manipulation. (at 104).

Summary of comparing circuit cases on issue of intent requirement “Although not explicitly described as such, case law in this circuit and elsewhere has required a showing that an alleged manipulator engaged in market activity aimed at deceiving investors as to how other market participants have valued a security.” (at 100).

Elements of manipulation under 10b-5: “Market manipulation requires a plaintiff to allege (1) manipulative acts; (2) damage (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange. See Schnell v. Conseco, Inc., 43 F.Supp.2d 438, 448 (S.D.N.Y.1999); Cowen & Co. v. Merriam, 745 F.Supp. 925, 929 (S.D.N.Y.1990).” (at 101).

Specific pleading requirements because it’s alleging fraud, must be pled with particularity under FRCP 9(b) (at 101). “This pleading requirement is particularly important in manipulation claims because in some cases scienter is the only factor that distinguishes legitimate trading from improper manipulation.” (at 102).

Cites to article “Future-Priced Convertible Securities and the Outlook for “Death Spiral” Securities-Fraud Litigation,” see below, 26 Whittier L. Rev. 359, 359-360 (Winter 2004).

Billing v. Credit Suisse First Boston Ltd., 426 F.3d 130 (2d Cir. 2005)
(Westlaw link, log-in required – click here)

Another implied immunity case, like Friedman, below, that gives background on laddering and tie-ins.
NOTE: Red flag indicates S.Ct decision that overturned COA case, but appears only to concern antitrust versus securities claim part of holding. This is related to In re Initial Public Offering Antitrust Litigation case, 2003.

Christ-Craft Industries, Inc. v Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973)
(Westlaw link, log-in required – click here)
In Bangor Punta Corporation v. Chriscraft Industries, Inc. decision (one of the three consolidated cases considered in this case), an action was brought under Section 9(a)(2) and 10(b) (see p. 380). Plaintiffs alleged defendants artificially inflated price of defendants’ stock so that at time of exchange offer, it was a deceptively attractive offer and also drove up the price of plaintiffs’ stock. Court found no manipulation and no manipulative intent. So long as the investor’s motive in buying or selling a security is not to create an artificial demand for, or supply of, the security, illegal market manipulation is not established.” (at 383, citing to Section 9(a)(2))

Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 795 (2d Cir. 1969)
(Westlaw link, log-in required – click here)
This was a suit under both Section 9(a)(2) (brought through 9(a)(3)’s private right of action provision), 10b-5 (as a failure to disclose, not manipulation claim) and the court found violations of both. The court defines the elements of manipulation under Section 9(a)(2) in a simplified way: “When a person who has a ‘substantial, direct pecuniary interest in the success of a proposed offering takes active steps to effect a rise in the market’ in the security, we think that a finding of manipulative purpose is prima facie established. Here we have even more than a motive to manipulate joined with the requisite series of transactions. In furtherance of its interest in defeating the Crane tender offer and consummating its own merger with Air Brake, Standard took affirmative steps to conceal from the public its own secret sales off the market at the same time it was dominating trading in Air Brake shares at a price level calculated to deter Air Brake shareholders from tendering to Crane.” (at 795) Court rejected the argument that the defendant had no manipulative intent because it was buying a substantial amount of stock in order to gain control of the corporation: “Knowing that running up the price of Air Brake stock on April 19 would discourage acceptance of the Crane offer, Standard's extraordinary purchases and simultaneous sales on April 19 cannot be explained solely by an alleged ‘purpose’ to acquire voting control consistent with the scope and design of section 9(a)(2).” (at 795).

Desai v. Deutsche Bank Securities Ltd, 573 F.3d 931, 939 (9th Cir. 2009) (Per Curiam)
(Westlaw link, log-in required – click here)
This is one of the most recent market manipulation cases to come out of the circuit courts (and there are no other more recent circuit court cases citing to it as of 4/28/10). This is a class action case and the result was that the court affirmed the district court’s decision to deny class certification. In addition to considering class certification, the court also discussed the plaintiffs’ market manipulation claims and particularly the element of reliance.

This differs from the “traditional” manipulation case in that the scheme involved securities loans. The court explains how the classic manipulative technique of driving the price up to create investor interest and then selling them off to reap a profit is not very profitable since by selling, the manipulator depresses the price. It then explained how the manipulation in this case avoided that problem:
“According to Investors, a web of schemers (including several persons no longer defendants) used securities loans to profit contemporaneously with the inflation of GENI's stock price, rather than by selling the stock after the price rose (which would have depressed the price).” (at 934, goes on to explain how it worked in more detail).

And also...

“As the district court put it, this scheme solved the classic problem of market manipulators everywhere: it allowed them to profit from fraudulently inflating a stock's price without having to sell the shares.” (at 935).

This case also breaks down Rule 10b-5 “deceptive and manipulative devices” into three categories: misrepresentations, omissions (+ duty to disclose predicate), and manipulative acts. (see p. 938). It discusses the differences between manipulation and deception. It fits misrepresentations and omissions into Rule 10b-5(b) and manipulative acts into “a scheme…to defraud” under 10b-5(a) or a “course of business which operates…as a fraud or deceit upon any person” in violation of 10b-5(c). Note that regardless of framing, elements are same as other 10b-5 claims (see Simpson case for same rule).

The court picks up the distinction between liability based on omissions versus manipulation in discussing the reliance element. (see pp. 940-942). It rejects the plaintiffs’ argument that the Affiliated Ute presumption of reliance (reliance is presumed in omission cases when information withheld is material, p. 939) should be extended to manipulation claims. Following the Tenth Circuit’s approach in Joseph v. Wiles, 223 F.3d 1155 (10th Cir. 2000), the court found that the presumption should not be extended to manipulation cases because the distinction between omission cases and manipulation cases should be maintained:

“We cannot allow the mere fact of this concealment to transform the alleged malfeasance into an omission rather than an affirmative act. To do otherwise would permit the Affiliated Ute presumption to swallow the reliance requirement almost completely. Moreover, it would fail to serve the Affiliated Ute presumption's purpose since this is not a case where reliance would be difficult to prove because it was based on a negative.” (at 941)

And also:

“We agree with the Tenth Circuit's approach, which carefully maintained the well-established distinction, for purposes of the Affiliated Ute presumption, between omission claims, on the one hand, and misrepresentation and manipulation claims, on the other.” (at 941).

The court also rejects another attempt by the plaintiffs to prove reliance based on a presumption that doesn’t apply—the fraud on the market theory, slightly modified. (see pp. 941-2). Plaintiffs argue that investors rely on the “integrity of the market” (that no one has manipulated the market,
affecting efficiency). Court rejects this expansion on several grounds, but then affirms relying on the denial of class certification. Judge O’Scannlain explains that the judges could not agree on correct approach about whether the reliance issues needs to be decided as a matter of law. See Davis Polk litigation release about this – click here


This is a private action (under 10b and 10b-5). It was brought by customers against accounting firm for failing to realize brokerage firm that customers invested with was a fraud. Court says manipulation is a “term of art” in context of securities market. (at 199). In context of private civil action for damages under 10b-5, it “connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.” (at 199). This mental state standard is not negligent nonfeasance (failing to use appropriate accounting methods in auditing brokerage firm), as plaintiffs wanted it to be in order for their cause of action against defendant accounting firm for aiding and abetting in the fraud: “When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances the commonly understood terminology of intentional wrongdoing and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct.” (at 214).

Rejects SEC’s amicus argument that “effect-oriented” test should be used to evaluate conduct that has a manipulative intent, regardless of mental state (court rejects because that ignores language of 10(b) which proscribes “manipulative or deceptive” devices/contrivances. Cites in footnote 21 to Webster’s definitions of “manipulate”—first the general one meaning to treat fraudulently and then the definition in the context of exchanges, meaning to force prices in an artificial direction by wash sales, etc. (at 198-200)

In reviewing legislative history, notes that section 10(b) evolved from Section 9(c). (at 200). Then quotes spokesman for drafter who said that 9(c) was designed as a catchall so that SEC would have authority to deal with new manipulative/deceptive devices. (at 202).

SEC (as amicus) tried to argue that comparing section 9 with 10 shows that when Congress wanted to include a willful/knowing scienter element, it did (in section 9). Therefore, section 10’s lack of language indicating such a mental state indicates negligence could be enough. (at 207). (Court rejects)

Footnote 32 discusses the enactment of Rule 10b-5 in 1967 and how it was written hastily in reaction to president of corporation spreading false negative information about the stock so that the price was driven down, then buying the shares at the depressed price. The rule was enacted the same day the report of this conduct was received.

Friedman v. Salomon/Smith Barney, Inc., 313 F.3d 796 (2d Cir. 2002) *(Westlaw link, log-in required – click here)*

Discusses how the SEC has declined to regulate stabilization in the aftermarket (such as flipping). Case is brought by retail investor plaintiffs claiming the defendants (underwriters and brokerage
firms) restricted their resale of securities for a period of 30-90 days after the IPO to discourage flipping, which it did not do with institutional investors’ shares. The court held that the defendants enjoy implied immunity because of the conflict with securities provisions. On pages 801-802 the court discusses how stabilization has been regulated and concludes that the SEC has a policy of not regulating stabilization in the aftermarket.

GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 207 (3d Cir.2001)  
(Westlaw link, log-in required – click here)  
This controversial 10b-5 manipulation case involved a lender and borrower suing over promissory notes. If the borrower could show that the lender engaged in short sales to artificially depress stock prices in violation Rule 10b-5, then it was entitled to rescission of the notes. The court outlined the elements for finding conduct manipulative under Rule 10b-5 and articulated a specific intent requirement: “(1) in connection with the purchase or sale of securities, (2) GFL engaged in deceptive or manipulative conduct by injecting inaccurate information into the marketplace or creating a false impression of supply and demand for the security (3) for the purpose of artificially depressing or inflating the price of the security.” (at 207) (emphasis added).
The court gave examples of practices satisfying this requirement: unauthorized parking of stock, existence of secret agreements designed to induce others to sell short on manipulator’s behalf, wash sales, matched orders, or making of false statements to investors.

The court rejected the borrower’s argument that the lender’s short selling was manipulative because it conveyed negative information: “[C]onveying negative information about a firm does not constitute market manipulation unless the information is untruthful. Indeed, legitimate short sales often convey negative information about a company insofar as short sales suggest that a stock’s price is overvalued, but that does not mean that such sales distort the market. To the contrary, short selling can help move an overvalued stock’s market price toward its true value, thus creating a more efficient marketplace in which stock prices reflect all available relevant information about the stock's economic value.” (at 208). Follows Sullivan & Long, 7th Cir. case.

Gurary v. Winehouse, 190 F.3d 37 (2d Cir. 1999)  
(Westlaw link, log-in required – click here)  
On appeal from grant of summary judgment for defendant, court held that the plaintiff-purchaser could not establish unlawful stock manipulation by defendants because plaintiffs knew defendants had allegedly manipulated stock price and therefore plaintiffs could not show reliance element. (at 45).

Offers definition of manipulation: “The gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators.” citing Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 12 (1985) (at 45).

Note that this is a private 10b-5 case, and one of the propositions this case is cited for (see Hazen treatise, Chapter 12, around n. 56) is that in private suits, an actual effect on the price (as opposed to engaging in conduct calculated to artificially affect price) is required. A plaintiff must show he suffered loss as a result of manipulation in order for him to have private remedy under this section.
Herman & MacLean v. Huddleston, 459 US 375 (1983)
(Westlaw link, log-in required – click here)
This case makes simple point that remedies under 10b-5 and Section 11 of 33 Act are cumulative.

In re Initial Public Offering Securities Litigation, 241 F.Supp.2d 281 (S.D.N.Y. 2003), aff’d
Tenney v. Credit Suisse First Boston Corp., No. 05-3450-cv, 2006 WL 1423785 (2d Cir. May 19, 2006)
(Westlaw link, log-in required – click here)
This case considers an allegedly manipulative scheme of an underwriter who required investors to “make aftermarket purchases in order to receive IPO allocations.” (at 388). Defendants try to rely on a case from the SDNY which interpreted Mulheren and allege that the elements for market manipulation come from Mulheren and include profit or gain to the alleged manipulator, market domination, and economic reasonableness of the alleged transaction (at 391). Court rejects this as the test, since the court in Mulheren, a criminal case on a direct appeal of a jury verdict, assumed without deciding that the scienter test was a “sole purpose to affect market price” test. Discusses elements:
“The elements of a Rule 10b-5 market manipulation claim are well-settled in this circuit. Section 10(b) and Rule 10b-5 impose primary liability upon those persons or entities who employ manipulative and deceptive practices while engaged in a scheme to defraud. To state a claim for market manipulation, Plaintiffs must allege that (1) they were injured; (2) in connection with the purchase or sale of securities; (3) by relying on a market for securities; (4) controlled or artificially affected by defendant’s deceptive or manipulative conduct; and (5) the defendants engaged in the manipulative conduct with scienter.” Blech II, 961 F.Supp. at 582 (citing Ernst & Ernst, 425 U.S. at 199, 96 S.Ct. 1375). Accord In re Sterling Foster & Co., Inc., Sec. Litig., 222 F.Supp.2d 289, 303-04 (E.D.N.Y.2002).”

See also pages 387-390 – court finds that tie-in agreement was unlawful manipulation not within stabilization permitted by Rule 104

Jaffee & Co. v. SEC, 446 F.2d 387 (1971)
(Westlaw link, log-in required – click here)
Like Burns, this case is an old stabilization case considering the scienter requirement for rule 10b-6 (precursor to Reg M’s Rule 101). This case, unlike Burns, however, is pre-Ernst & Ernst, which established that scienter is necessary to prove Section 10(b) violations. The court held that there was no requirement that the SEC prove the defendant intentionally violated the rule: “Where the rule applies, its prohibition is absolute.” (at 391).

Koeppe & Co., et al v. SEC, 95 F.2d 550 (7th Cir. 1938)
(Westlaw link, log-in required – click here)
This older case is frequently cited in law reviews (see, for example, the Starr & Herman article) and treatises as an example of a manipulation scheme involving both manipulative conduct and
an omission of fact. Charges were brought here under Section 17(a) of the 33 Act and Sections 9(a)(1), (2), and (3) of the 34 Act. The SEC said that the defendants were selling stock to the public without disclosing that it had been manipulated. Question on appeal was evidentiary sufficiency. The stocks manipulated were registered under the Securities Act and one security traded on the Chicago Curb Exchange, the other on the Chicago Stock Exchange. The defendants held about 45,000 shares in a certain stock which it traded on the Chicago Curb Exchange. Most of these sales were made by the defendant through 12 different stock exchanges or members of the NYSE. (at 552). Since defendant had been expelled from the CCE, the transactions were in the name of someone as the nominee as the defendant. The price was raised “some 200%” during the trading. (at 552). The defendants also employed a third party to “tout” the stock, paying the third party a commission for transactions prompted by his recommendations. (at 552). The price subsequently tumbled.

Markowski v. Securities and Exchange Commission, 274 F.3d 525 (D.C. Cir. 2001)
(Westlaw link, log-in required – click here)
The posture is review of SEC’s order sustaining disciplinary action by NASD. So court applied standards of review for administrative agency—for law, Chevron deference; for facts, substantial evidence. Court rejected defendant’s argument that because trades were real/not fictitious, there can be no liability. Giving the SEC Chevron deference, the court upheld the SEC ruling that even if trades not fictitious, manipulation occurs when trades are without investment purpose/with intent to affect the price. This is a 10b-5 prosecution, but in discussing manipulation, the court notes that Section 9(a)(2) of 34 act is more general than Section 9’s prohibition of specific transactions such as wash sales, etc. This is consistent with SEC Rule 10b-18 about issuer’s repurchase of own securities and specific safe harbors therein. The manipulative purpose here was to maintain customer interest in stock, not to profit from stock. Therefore it does not negate any scienter to show that defendants did not profit from manipulation.

Pagel, Inc. v. Securities and Exchange Commission, 803 F.2d 942, 946 (8th Cir. 1986)
(Westlaw link, log-in required – click here)
The Eighth Circuit upheld an SEC decision finding that the broker-dealer defendant violated Rule 10b-5 by manipulating the price of a stock. On a substantial evidence standard of review of the SEC’s findings, the court found the SEC’s finding of intent sufficiently supported by substantial evidence. (at 946). Intent can be proved indirectly as an inference from circumstantial evidence: “We believe the Commission could reasonably have inferred from the evidence of price movement, trading activity, and other factors that the manipulation was undertaken for the purpose of securing financial and tax benefits for petitioners and thus was intentional.” (at 946). Court did not require intent that defendant manipulated in order to deceive others in the market about how the security is valued by market participants. (In ATSI Communications v. Shaar Fund, Ltd. v. Shaar Fund, Ltd., 493 F.3d 87, 100 (2d Cir. 2007), the court uses this as an example of a court that takes a different approach to the intent requirement.)

Santa Fe Industries, Inc. v. Green, 430 US 462 (1977)
(Westlaw link, log-in required – click here)
This is a 10b-5 private action by minority shareholders against majority shareholders (and firm that evaluated stock value for purposes of merger) alleging actionable injury based on how they were offered to have their shares bought out to effect a short-form merger eliminating minority
interest. Court builds on Ernst definition and states that “manipulation” refers to practices “such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.” (at 477). Court refuses to find “manipulation” where corporate managers breached fiduciary duties owed to shareholders. (at 477). “Section 10 (b)”’s general prohibition of practices deemed by . . . the SEC to be ‘manipulative’ - in this technical sense of artificially affecting market activity in order to mislead investors - is fully consistent with the fundamental purpose of the 1934 Act ‘to substitute a philosophy of full disclosure for the philosophy of caveat emptor . . . ’ . . . Indeed, nondisclosure is usually essential to the success of a manipulative scheme. No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices. But we do not think it would have chosen this ‘term of art’ if it had meant to bring within the scope of 10 (b) instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.” (at 477) (internal citations omitted).


(See Westlaw link, log-in required – click [here](#)  

Shareholders of target corporation alleged that cancellation of hostile takeover offer and replacement with friendly takeover agreement was manipulative in violation of tender offer provision, Section 14(e) of the Exchange Act. [15 U.S.C. § 78n(e)] not 10(b). Section 14(e) “manipulation” requires misrepresentation or nondisclosure. Plaintiff tried to argue that “manipulative/deceptive” acts include those which, *although fully disclosed*, “artificially” effect price of takeover target’s stock. (at 6). Court rejects this, stating that plaintiff misunderstands the meaning of word “manipulative,” which the court has defined in the 10(b) context (Ernst & Santa Fe cases) and found that the word connotes element of intentional or willful conduct and also is a general term used to describe a range of misleading practices. (at 6). Court discusses how 10(b) cases construing meaning of word “manipulative” is consistent with meaning at common law and ordinary dictionary definition (See footnotes 4 and 5) (at 7).

**SEC v. Burns, 614 F.Supp. 1360, 1362-63 (S.D. Cal. 1985), aff’d 816 F.2d 471 (9th Cir. 1987)**

(See Westlaw link, log-in required – click [here](#) 

This SEC enforcement action considered former rule 10b-6, which is Reg M rule 101, prohibiting purchases during a distribution. Court held that, after Ernst & Ernst and Aaron v. SEC, it’s clear that Section 10(b) requires scienter be proven in order to allege a violation. Since Rule 10b-6 was enacted pursuant to that statutory grant of authority, the same applies here. Here, the SEC did not allege scienter, but after ruling that it is required to be plead, allows SEC to amend its complaint.


(See Westlaw link, log-in required – click [here](#) 

This is the only case in the citing references to Rule 10b-18 that actually involves an issuer/management defendants invoking 10b-18 as a defense to Section 9(a)/Rule 10b-5 manipulation charges. The posture of the case is review of defendants’ motion to dismiss on the grounds that their repurchases were made in accordance with the conditions of the safe harbor. The court rejects the motion because, among other things, the SEC had sufficiently show intent to manipulate by circumstantial evidence of marking the close, painting the tape, and matching
orders. Technical compliance with the safe harbor does not immunize repurchases from manipulation liability if intent is shown. Authority cited is “Note 1” to Rule 10b-18, which articulates this idea. There is no later case on the merits because some defendants settled and the case was decided against the other defendants on non-10b-18 issues.


This was a manipulation case brought under several provisions, including Sections 10(b) and 9(a)(2) of the Exchange Act and Section 17(a) of the Securities Act. In the case, the court found that two broker-dealers engaged in market manipulation by not acting as legitimate market-makers when quoting excessive bids (bids that exceed amount created by demand of stock in open market) to clients and conducted “wash sales” by buying (secretly on behalf of the issuer) and then selling back to the issuer at a profit pursuant to a “guaranteed profit” agreement. The court defines market manipulation and what is required to prove it—don’t need to show manipulative intent; that’s inferred from conduct. Indirect evidence allowed. The court rejected the defense that the defendants were acting as legitimate market makers—it doesn’t make sense that in order to make it more liquid, broker-dealers would purchase so much ($44 million) of such a risky stock and then almost immediately sell it back to issuer.

Key quotes about scienter:

“Scienter has been defined as a “mental state embracing intent to deceive, manipulate, or defraud.” Ernst & Ernst, 425 U.S. at 193, 96 S.Ct. at 1381. It is well settled that proof of scienter where securities manipulation is the gravamen of the action need not be established through direct evidence. Rather, the scienter requirement is satisfied when it has been shown that defendants pursued a course of conduct that constituted market manipulation as a matter of law. Herman & MacLean v. Huddleston, 459 U.S. 375, 391 n. 30, 103 S.Ct. 683, 692 n. 30, 74 L.Ed.2d 548 (1983).” (at 197-98)

“[S]ection 10(b) does not require a showing of manipulative purpose; such purpose may instead be presumed upon a showing of a course of conduct that has the effect of manipulating the securities market for certain stocks. “It is sufficient for the person to engage in a course of business which operates as a fraud or deceit as to the nature of the market for the security.” In re Batterman, Release No. 34-12278, 46 S.E.C. 304, 305, 1976 WL 19966, at *2 (Mar. 29, 1976) (footnote omitted). (at 196-97).


This recent district court case considered a manipulation case under 10b-5. The court was reviewing the defendant’s motion for summary judgment. The alleged manipulation involved “marking the close.”

This case raises 2 important legal issues:
Issue 1: What is required to prove manipulation in an open-market transaction (where the trades are real and there is a change in beneficial ownership). (at 367). Specifically, are otherwise legitimate open-market transactions transformed into illegal market manipulation solely based on the trader’s state of mind when the trades were executed?

The court sets up a dichotomy of market manipulation cases. (at 367). There is conduct which closely resembles fraud, such as wash sales, matched orders, or rigged prices. (at 367). Then there are cases where there the conduct (means to accomplish the manipulation) is not per se illegal—“such as short selling and large or carefully times purchases or sales of stocks.” (at 367). “In these cases, the transaction is real, to the extent that beneficial ownership is changing and the volume of trading is reflective of market activity. The difficulty in such “open-market” cases, where the activity in question is not expressly prohibited, is to “distinguish between legitimate trading strategies intended to anticipate and respond to prevailing market forces and those designed to manipulate prices and deceive purchasers and sellers.” GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 205 (3d Cir.2001). The question arises whether manipulative intent alone is enough to make open-market transactions manipulative and in violation of securities laws.” (at 367). The court goes on to outline the different circuit approaches, since the Second Circuit has not considered the issue. (at 367-68). One court has held that manipulative intent is not alone sufficient to transform an open-market transaction into illegal manipulation (the Third Circuit, in GFL Advantage Fund, Ltd.). In the Markowski case, however, the court accepted the SEC’s interpretation that manipulative intent was enough. The court also reviews the split among the district courts (including the In re Initial Public Offering Securities Litigation, which rejected a rule that open-market transactions should require any additional elements). (at 369). It cites two SEC settlement orders, and notes that the SEC bases liability on “marking the close” alone, i.e. following the Markowski line of cases, but noted that those cases involved a two-month scheme of such behavior. (at 371). The court ultimately rejects GFL Advantage Fund, criticizing that court’s requirement that there be additional deceptive or fraudulent conduct in order to find manipulation. (at 369.) It criticizes the Third Circuit approach for creating a new requirement that is unsupported by the statutes, regulations, or case law. (at 369). The court also critiques the approach as being inconsistent with the economic rationales for regulating manipulation because open-market transactions with manipulative intent injects inaccurate information into the marketplace. (at 372, n. 17). The rule the court ultimately adopts is:

[I]f an investor conducts an open-market transaction with the intent of artificially affecting the price of the security, and not for any legitimate economic reason, it can constitute market manipulation. Indeed, “the only definition [of market manipulation] that makes any sense is subjective—it focuses entirely on the intent of the trader.” Fischel and Ross, supra, at 510.FN18 Allegations of other deceptive conduct or features of the transaction are only required to the extent that they render plausible allegations of manipulative intent. (at 372). In this particular case, the court found the allegations sufficiently indicative of manipulative intent to state a claim for manipulation. (at 372).

Issue 2: “[w]hether an open-market transaction unaccompanied by deceptive or fraudulent conduct can support liability for market manipulation where the defendant has both a manipulative and non-manipulative intent, whether it requires that the sole intent be to artificially affect the price of the stock, or whether some other standard is appropriate.” (at 372).
Court adopts a “but-for” rule “The Court holds that in order to impose liability for an open market transaction, the SEC must prove that but for the manipulative intent, the defendant would not have conducted the transaction.” (at 372). The court adopted this rule because (1) in Mulheren, the Second Circuit did not accept the SEC’s sole intent rule (i.e. liability could be imposed where the SEC shows that the transaction was undertaken with the sole intent of affecting prices, not for an investment purpose) so therefore it would not get behind a rule that said manipulation could be found where only one of the purposes was to affect price; (2) If a transaction would have been conducted for investment purposes or a valid economic reason, then you cannot say it’s “artificially” affecting the price or injecting inaccurate information into it; (3) Court applied substantive canon of construction that when considering a rule that would proscribe otherwise legal activity based only on intent, the court should err on the side of caution. (at 373). Applying the rule in this case, the court found the SEC raised a genuine issue of material fact as to whether the investor-defendant would have entered into the transaction but for his alleged manipulative intent. (at 375). (but the broker’s motion for summary judgment was granted on this issue because evidence showed broker was just following investor’s directions and trades not suspicious enough to have put broker on notice).

This case was never appealed to the Second Circuit—the SEC dropped the charges in August 2008. See litigation release.

This case generated case reports by practitioners analyzing the impact of this case.

1. **New York Law Journal piece, “‘Masri’ and Open-market Manipulation Schemes,” by Michael A. Asaro, Akin Gump partner (May 12, 2008) – click here**: After Masri, the authors conclude the case has potentially serious ramifications for investment professionals who pursue investment strategies that have an impact on market prices. And also that “The issue is also particularly timely in light of the growing wave of SEC enforcement cases and private lawsuits against hedge funds for employing perfectly legal trading strategies such as short selling for allegedly improper manipulative purposes.” (p. 1). The author suggests this case could embolden litigants, the SEC, and the government to pursue market manipulation cases where defendants have engaged in practices that have affected prices.

2. **Morgan Lewis “Law Flash,” “What Turns Legal Conduct into Market Manipulation? A District Court Answers That Bad Intent Is Enough, But Only Where It Is the Sole Intent,” by Anne C. Flannery and Adrienne M. Ward (November 29, 2007) – click here**: After summarizing the Masri case, the authors conclude that Masri “offers a sensible and balanced approach to such cases when there are few or no indications of manipulative intent (e.g., the activity in question is isolated or sporadic; there are equally plausible and innocent explanations for the activity; or there are no dubious statements in emails). In particular, while a regulator may treat the broker and investor as one and the same, Masri requires an independent evaluation of the broker’s conduct.” (p. 3) The authors continue by offering advice to broker-dealers who are conducting an internal review or facing regulatory inquiries. (p. 3).


(Westlaw link, log-in required – click here)
This case is cited by secondary sources (along with Knoppe) as a “conduct + omission”-based liability manipulation case. The court charges the defendants with breaching their duty to inform the purchasers “that no attention should be paid to the market price in considering whether or not to complete the purchases.” (at 979). The charges were brought not just under the anti-fraud and anti-manipulation sections of the 33 and 34 Acts, but also under the net capital and bookkeeping provisions of the 34 Act. (see pp. 973-74). The court found that the broker-dealers violated Section 17(a) and Rule 17a-3 for failing to insure their firm’s books and records were kept in compliance with the Exchange Act. (at 979). They also found a violation of the Net Capital Rule, Rule 17c3-1, because they were clearly insolvent when they continued to deal with their customers on a “business as usual” basis. (at 979-80).

This case also offers a quote that connects the dots between Sections 10(b) and 9(a)(2) of the Exchange Act with Section 17(a) of the Securities Act:

“It is well settled that the manipulative activities expressly prohibited by § 9(a)(2) of the Exchange Act with respect to a listed security are also violations of § 17(a) of the Securities Act and § 10(b) of the Exchange Act when the same activities are conducted with respect to an over-the-counter security.” (at 975).

SEC v. Sierra Brokerage Services, Inc.  608 F.Supp.2d 923 (S.D. Ohio 2009)
(Westlaw link, log-in required – click here)
Case considers alleged pump-and dump scheme (at 960) in the context of whether summary judgment is appropriate on market manipulation claim.

Discusses use of inferences and notes how the question of whether manipulation occurs is a fact question: “Determining whether manipulation occurs requires the fact-finder to make "inferences drawn from a mass of factual detail" because "[f]indings must be gleaned from patterns of behavior, from apparent irregularities, and from trading data." In Re Pagel, Inc., Exchange Act Release No. 22,280, 1985 WL 548387, at *3 (Aug. 1, 1985), aff'd sub nom., Pagel, Inc. v. SEC, 803 F.2d 942 (8th Cir.1986).” (at 962)

Outlines relationship to 33 Act’s 17(a): “Section 9(a)(2) prohibits securities transactions that "creat[e] actual or apparent active trading in such security" but only applies to stocks listed on the exchanges. Sections 17(a) and 10(b), however, prohibit the same conduct as Section 9(a)(2) with respect to OTCBB stocks, like Bluepoint.” (at 961)

Provides elements of establishing “manipulative conduct”: “Courts have identified four factors indicating market manipulation: (1) control of the float, i.e., the number of shares available for trading; (2) dominance and control of the market for the security; (3) price leadership; and (4) collapse of the market after the manipulator's activities cease. SEC v. Martino, 255 F.Supp.2d 268, 287 (S.D.N.Y.2003); Resch-Cassin, 362 F.Supp. 964, 976 (S.D.N.Y.1973).” (at 962).

SEC v. U.S. Environmental, Inc., 155 F.3d 107 (2d Cir. 1998)
(Westlaw link, log-in required – click here)
This case came to the Second Circuit when the court granted the SEC’s motion for interlocutory appeal to answer the question certified by the district court about the level of scienter required to
find that a trader employed by defendant violated 10b-5 by manipulating a security. Court held that: “We hold that [the defendant] can be primarily liable under § 10(b) for following a stock promoter's directions to execute stock trades that [he] knew, or was reckless in not knowing, were manipulative, even if [he] did not share the promoter’s specific overall purpose to manipulate the market for that stock.” (at 108). Court discusses Supreme Court’s Central Bank holding about primary liability for 10(b) violations. (at 110-11). Court held that the district court conflated the Central Bank distinction between primary violators and aiders/abettors with the issue of scienter and that whether the defendant was a primary or secondary actor turns on the nature of his acts, and not his state of mind. (at 111)). The court concludes that since the defendant made the buy and sell orders that artificially manipulated the stock, he was a primary violator (at 112), and that the complaint sufficiently alleged scienter (that was all that was being considered for the scienter element on this appeal of a 12(b)(6) dismissal of complaint.

- Court distinguished how manipulation liability under 10b-5 is different from 10b-5 omission liability. Here, defendant himself committed a manipulative act by executing the trades. (at 112).
- This case, which is about 12 years old now, has some negative cases following it, but they are all from district courts.
- Court notes how the PSLRA of 1995 affects Central Bank (at 113). PSLRA was enacted after Central Bank and provides that anyone who provides “substantial assistance” to another in violating [Section 10(b) or rules enacted under it] is deemed a primary violator. Court concludes: “Thus, unlike private plaintiffs, the SEC now has authority to assert aiding and abetting claims under § 10(b). [citations omitted] “It remains unclear, however whether the SEC could being aiding/abetting claims in cases based on conduct occurring prior to the enactment of the Reform Act.” (at 113).

**Sullivan & Long, Inc. v. Scattered Corp., 47 F.3d 857, 861 (7th Cir. 1995)**

*(Westlaw link, log-in required – click here)*

This case considered a scheme where a market-maker defendant sold short more shares than were outstanding (tens of millions). Court of Appeals (Posner, J.) affirmed the district court’s dismissal for failure to state a claim of market manipulation under 9(a)(2) and 10b-5. Plaintiffs were buyers on the other side of the short sales. Plaintiffs alleged that this was “market manipulation” but court rejects it, describing the scheme instead as permissible arbitrage. Because the scheme served the main purpose of the securities laws, to maintain accurate prices, it could not be found as a violation of the 34 Act

Provides a more consistent test for manipulation—holistically, does the practice move the price away from the fundamental value: “What troubles us most about this suit is the plaintiffs' failure to identify any harm to the objectives of the securities laws under which they have sued; for that matter they have failed to identify a rule that [Defendant] violated. The central objective, we take it, is to prevent practices that impair the function of stock markets in enabling people to buy and sell securities at prices that reflect undistorted (though not necessarily accurate) estimates of the underlying economic value of the securities traded.” (at 861) ** But to recapitulate the essential point of this opinion, since the conduct in which Scattered engaged appears to have served rather than disserved the fundamental objectives of the securities laws, we are not inclined to strain to find a violation of a specific provision.” (at 865).
Definition of market manipulation: “term that refers to tactics by which traders, like monopolists, create artificially high or low prices, prices that do not reflect the underlying conditions of supply and demand.” citing Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). (at 861)

Court rejects plaintiffs’ claim that defendants violated Rule 9(a)(2) of the 34 Act, because the transactions were not shams—there were real buyers on the other side of the short selling, and also defendant did not make any untrue statements about the number of shares it was short selling (at 864).

Court rejects plaintiff’s 10b-5 claims because nothing “deceptive” occurred (at 864-65). “no nondeceptive practice in which Scattered engaged was manipulative in the sense—the only possibly relevant legal sense—of bringing about artificial prices for LTV stock.” (at 865)

United States v. Mulheren, 938 F.2d 364 (2d Cir. 1991)
(Westlaw link, log-in required – click here)
This scheme alleged defendant purchased 75,000 shares of stock with purpose of driving price up so that friend Boesky could sell shares in same stock back to the company at higher price. The government offered a standard for scienter, i.e. “manipulative intent”: the defendant may be held liable for unlawful manipulation if he entered into the transaction with the sole purpose of affecting the price and not for any investment purpose. The court assumes this test is appropriate without adopting it. Under this test, the court found the jury verdict finding the defendant guilty could not be upheld because the government failed to prove, beyond a reasonable doubt, that (1) the defendant knew Boesky had a stake in the stock, and that (2) the defendant agreed to purchase shares of that stock for the sole purpose of driving up the price. Additionally, the court found it important that the defendant lost over $64,000 in the scheme and also that he purchased significantly more shares than were needed to affect the price.

This was a unique situation because defendant was corporate outsider and it was alleged that he engaged in the transaction to help another. So looking at his transaction on its own it’s easier to see how it could have been for investment purposes not manipulation. Tying it in to manipulation required showing connection to third-party Boesky, which was hard to prove.

Teaches us that under this test, it would be very hard to ever find someone guilty of manipulation because it’s hard to prove the intent was solely to affect price and not investment purposes. And that it is especially hard with a criminal beyond-a-reasonable-doubt standard.
The court also notes that defendant’s purchase of more than needed (and the fact that he lost a lot of money) are “indicia” of manipulative intent.

This case is important in that it didn’t answer the question that the circuits have split over: whether an otherwise legal action is deemed manipulative solely based on intent. See Masri case for discussion.

United States v. Regan, 937 F.2d 823 (2d Cir. 1991)
(Westlaw link, log-in required – click here)
Coffee & Sale (11th Ed.) offer that this case, decided right before Mulheren, in same circuit, shows a difference of opinion regarding how to deal with manipulation claims. In this case,
defendants claimed that because they owed no fiduciary duties to parties that they traded with, they therefore had no duty to disclose that the market had been manipulated. Court rejected this and said that liability was not imposed for omission of material fact and no fiduciary duty predicate was required.

Simpson v. AOL Time Warner, Inc., 452 F.3d 1040 (9th Cir. 2006) (Case has red flag because it was vacated on other grounds by Avis Budget Group, Inc. v. Cal. State Teachers' Ret. Sys., --- U.S. ----, 128 S.Ct. 1119, 169 L.Ed.2d 945 (2008)).

This case is cited to mainly for laying out the elements of a manipulation claim in the Ninth Circuit. (See for example, Stokes law review article, around footnote 83, which compares this case to other circuits list of elements, such as the Second Circuit cases, the Third Circuit’s GFL Advantage Fund and the Seventh Circuit’s Sullivan & Long.)

Elements listed by Ninth Circuit in this Section 10(b) manipulation case are:

“A private action under § 10(b) and Rule 10b-5 must allege and prove all of the elements for primary liability for each defendant. The elements of a securities fraud claim are: (1) to use or employ any manipulative or deceptive device or contrivance; (2) scienter, i.e. wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in fraud-on-the-market cases as “transaction causation;” (5) economic loss; and (6) loss causation, i.e. a causal connection between the manipulative or deceptive device or contrivance and the loss. See Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 341-42, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005).” (at 1047).

And this was reiterated in another later case, noting that the elements remain the same regardless of how it is framed: “Regardless of whether a § 10(b) plaintiff alleges a misrepresentation, omission, or manipulation, he must plead and prove the following elements:…” Desai v. Deutsche Bank Securities Ltd, 573 F.3d 931, 939 (9th Cir. 2009) [case summarized in bibliography]

Then court goes through each element in this case. This case also adds to the discussion about “primary violations” (as opposed to violations as aider/abettor) in “schemes to defraud.” Court held that:

[T]o be liable as a primary violator of § 10(b) for participation in a “scheme to defraud,” the defendant must have engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme. It is not enough that a transaction in which a defendant was involved had a deceptive purpose and effect; the defendant's own conduct contributing to the transaction or overall scheme must have had a deceptive purpose and effect. (at 1048)

Here, the conduct alleged to have violated Rule 10b-5 was the defendants’ overstating the reported revenues of the securities issuer. Not market manipulation in traditional sense, more “deceptive device,” but discussion of elements and primary liability for secondary actors could be important.
This case also includes an extensive discussion of the Supreme Court case holding that there is no aider/abettor secondary liability, just primary liability for secondary actors (Central Bank case). See pp. 1047-48.
5. SEC Litigation Releases

(Organized by topic: settled SEC Actions, Rule 10b-18, and Reg M)

Settled SEC Actions

SEC v. Jonathan Lebed - See SEC press release
SEC brought this settled action against a teenager who used false names on internet sites to effect a pump and dump scheme. Cease and desist order shows the SEC was alleging violations of 10b-5.

SEC v. Paul Berliner – See SEC press release
SEC brought this settled action against Wall Street trader who sent instant messages to brokerage houses spreading false negative information. Defendant short sold stocks in company after spreading false negative information about the company, effecting a pump and dump short selling scheme. Litigation release shows settled suit was brought under 10b-5 and also 9(a)(4), which only applies to broker-dealers, among others

Rule 10b-18

10b-18 Final Rule: December 2003 amendments – click here for release
This release describes the amendments to rule 10b-18 adopted in 2003. Overall: “The amendments are intended to simplify and update the safe harbor provisions in light of market developments since the Rule's adoption. To enhance the transparency of issuer repurchases, we also are adopting amendments to a number of regulations and forms to require disclosure of all issuer repurchases (open market and private transactions), regardless of whether the repurchases are effected in accordance with the safe harbor rule.”

Division of Market Regulation: Answers to Frequently Asked Questions Concerning Rule 10b-18 ("Safe Harbor” for Issuer Repurchases) – click here for release
(originally released in 2003, but some questions has “new” flags, so looks like the document has been updated)
SEC answers FAQs after 2003 amendments to Rule 10b-18. (39 questions answered). Important topics covered are:
Cross-references to disclosure requirement technicalities, see “Introduction”:
• Point about compliance not protecting issuer from liability if there is either insider trading or manipulative intent—Question 1
• Covered securities – see Questions 2-12
• Accelerated Share Repurchase plans – Question 13
• Merger Exclusion – Questions 14-22
• Riskless Principal Transactions – Question 23

Regulation M
From April 2005—highlights prohibited behavior of underwriters

Amendments to Regulation M: Anti-Manipulation Rules Concerning Securities Offerings [Release Nos. 33-8511; 34-50831; IC-26691; File No. S7-41-04] RIN 3235-AF54 - click here for release
“Also, unlike the more general anti-manipulation provisions, Regulation M does not require the Commission to prove in an enforcement action that distribution participants have a manipulative intent or purpose. As a prophylactic, anti-manipulation measure, Regulation M is designed to prohibit activities that could artificially influence the market for the offered security, including, for example, supporting the offering price by creating the exaggerated perception of scarcity of the offered security or creating the misleading appearance of active trading in the market for the security.”
6. Law Firm Client Updates

Organized by topic: general manipulation, short selling with manipulation, and repurchasing.

General Manipulation (without short selling, see short selling list below)

Relating to Proposed Legislation (all of these are summarized in the “Proposed Legislation” section above)

Over-the-Counter Derivatives Market Act of 2009 (the “Frank Bill”)
* See note in “Section 9” above, from Goodwin Proctor release, Aug. 27, 2009 (more on same, see August 17, 2009 Davis Polk release and October 6, 2009 Davis Polk release).

Derivatives Markets Transparency and Accountability Act of 2009 (the “Peterson Bill”)
* See note in “Section 9” above, from Davis Polk release, Oct. 29, 2009

Wall Street Reform and Consumer Protection Act of 2009
* See note in “Section 9” above, from Davis Polk release, Dec. 11, 2009

Investor Protection Act of 2009
* See note in “Section 9” above, from Davis Polk release, July 13, 2009

The Authorizing the Regulation of Swaps Act (the “Levin-Collins Bill”)
* See note in “Section 9” above, from Davis Polk release, May 13, 2009

Sample manipulation cases:

SEC Charges Hedge Fund Manager and Bond Salesman with Insider Trading of Credit Default Swaps
“On May 5, 2009, the SEC charged a bond salesman and a hedge fund manager with insider trading involving credit default swaps (“CDS”). The case, the first ever involving insider trading of CDS, is a reminder that the antifraud provisions of the Securities Exchange Act of 1934 (the "Exchange Act") reach CDS relating to securities and any fraudulent activity, including insider trading and market manipulation, with respect to such CDS.” – Davis Polk release, May 8, 2009 (has links to SEC documents)

See releases in Masri case annotation, above

See releases in Desai case annotation, above

Other:

SEC Cooperation Initiative: SEC Announces Initiative To Encourage Cooperation in Investigations and the Creation of Five New National Specialized Enforcement Units
SEC proposal of Jan. 13, 2010 to create five new national specialized enforcement units, including “The Market Abuse Unit, which will focus on large-scale and organized insider trading and market manipulation schemes.” - Davis Polk release, Jan. 15, 2010

SEC Conducting Examinations to Review Controls Against the Spreading of False Information and Stock Price Manipulation

“On July 13, 2008, the SEC announced that, along with the Financial Industry Regulatory Authority ("FINRA") and the New York Stock Exchange ("NYSE"), it would be conducting examinations in order to prevent the intentional spread of false information intended to manipulate securities prices. The SEC, FINRA and NYSE examinations focus on whether investment advisers' and broker-dealers' supervisory and compliance controls are reasonably designed to prevent the intentional spreading of false information and other conduct aimed at manipulating securities prices. SEC Chairman Christopher Cox called the examinations a "double-check," to ensure that "sturdy controls" are in place to prevent such conduct. As part of its examinations, the SEC has sent many registered investment advisers letters reminding them of their obligations regarding the intentional dissemination of false information and seeking information regarding the adviser's compliance efforts. The SEC letters request information such as . . .” - Davis Polk release, Aug. 4, 2008 (See related release, below)

SEC Sends “Sweep Letters” Regarding Custodial Arrangements and Rumor-Mongering

“On February 13, 2009, the SEC sent a "sweep letter" to various registered investment advisers and broker-dealers requesting information concerning custodial arrangements for the safekeeping of client assets. The SEC also sent a "sweep letter" to registered investment advisers on February 10, 2009 requesting information regarding the manipulation of securities prices through the malicious use of false or misleading rumors. The letters are consistent with recent statements by SEC Chairman Shapiro, as discussed in “SEC Chairman Outlines Priorities” above, indicating that the SEC would promote sound custodial practices and reinvigorate enforcement initiatives. * * * The rumor-mongering letter requests information from registered investment advisers regarding reviews by such advisers in relation to the malicious use of false or misleading rumors in connection with price manipulation. Additionally, the letter asks advisers to provide information concerning changes to policies on, and employee training in connection with, rumor-mongering. Notably, the letter requests information regarding how advisers monitor employee Internet use and adviser policies for monitoring the use of personal mobile communications devices by portfolio management and trading personnel.” - Davis Polk release, March 3, 2009

“SEC Expanding Market Manipulation Investigation-Will Require Statements Under Oath”

“On September 19, 2008, the SEC announced an expansion of its investigation into alleged manipulation of the securities of financial institutions. As reported in the August 2008 Investment Management Regulatory Update, the SEC, in coordination with NYSE Regulation and FINRA, is examining investment advisers and broker-dealers to evaluate their compliance controls relating to preventing the spread of false information. The SEC's expansion of the investigation will require certain hedge fund managers, broker-dealers and institutional investors to provide statements under oath regarding their trading positions. A formal order approved by
the Commission will also allow SEC enforcement staff to subpoena additional documents or require testimony.” – Davis Polk release, Oct. 8, 2008

With Short Selling

Naked Short Selling Regs: Rule 204T and 203(b) of SHO, and Rule 10b-21

“On July 27, 2009, the Securities and Exchange Commission (“SEC”) adopted final Rule 204 of Regulation SHO (“Rule 204” or the “final rule”) under the Securities Exchange Act of 1934, making permanent, with minor changes, the firm delivery and close-out requirements for sales of equity securities contained in temporary Rule 204T of Regulation SHO (“temporary Rule 204T” or the “temporary rule”). Among the minor changes, the final rule provides broker-dealers with some limited increased flexibility by allowing them to close out fails by either borrowing or purchasing securities in certain situations where the temporary rule required purchases, and expanding the class of securities eligible for a 35-day close-out period to include certain securities the seller is deemed to own. The rule is part of the SEC’s efforts to curtail potential “naked” short selling abuses and reduce fails to deliver. Rule 204 will become effective on July 31, 2009, upon the expiration of temporary Rule 204T. In its press release regarding Rule 204, the SEC also indicated that it will not renew temporary Rule 10a-3T (Form SH), which is set to expire on August 1, 2009. Under this temporary rule, which has been in effect since September 2008, institutional investment managers have been required to report their short positions. In lieu of renewing temporary Rule 10a-3T, the SEC announced a joint effort with self-regulatory organizations (“SROs”) aimed at increasing public availability of short sale data by providing short sale volume and transaction data on SRO websites. Details regarding the program have not yet been announced, although it appears that the intent is not to publicly identify individual short sellers or position holders.” - Davis Polk release (click here), July 28, 2009

On September 17, 2008, the SEC issued new rules to protect investors against “naked” short selling and also announced an intention to take further regulatory and enforcement actions relating to short sales. The new rules, Rule 204T of Regulation SHO, an amendment to Rule 203(b) of Regulation SHO and Rule 10b-21 under the Securities Exchange Act of 1934, will apply to the securities of all public companies.- Davis Polk release, Sept. 18, 2008. Note: Rule 204T was to expire July 31, 2009. See SEC release, Oct. 2008. The rule was made into permanent Rule 240, see above

Investment Advisory Firms Charged with Unlawful Short Selling Practices

“On January 26, 2010, the SEC separately charged two investment advisory firms, Palmyra Capital Advisors LLC (“Palmyra”) and AGB Partners LLC (“AGB”), along with AGB’s principals, Gregory A. Bied and Andrew J. Goldberger, with engaging in unlawful short selling of securities. According to the SEC, the two cases are the first to be brought under Rule 105 of Regulation M since the rule was amended in October 2007. In both cases, the charges were settled without any admission or denial of the SEC’s findings. Prior to its amendment, Rule 105—a rule designed to prevent market manipulation—generally made it unlawful to use securities purchased in a public offering to cover a short sale of such securities effected within the five days preceding the offering’s pricing date. As amended, Rule 105 generally makes it unlawful merely to purchase a security in a public offering after having sold the same security short within
the five days preceding the offering’s pricing date.” – Davis Polk release, Feb. 5, 2010

**Repurchases**

**“Issuer Share Repurchase Safe Harbor: SEC Proposes to Clarify and Modernize Rule 10b-18”** – click [here](#) for client update

This release was published on February 4, 2010 and concerns an SEC proposal made on January 29, 2010, that asks for comments due March 1, 2010. The proposed rule seeks comments on:

- The time of purchase condition, which currently requires that a Rule 10b-18 purchase not be the opening purchase for the security in the consolidated system, would be modified to require that it also not be the opening purchase in the principal market for the security or in the market where the purchase is effected;
- The price condition, which currently requires that a Rule 10b-18 purchase be made at a price no higher than the highest independent bid or the last independent sale price (whichever is higher), would be modified to permit a Rule 10b-18 purchase to be made on any trading day at a volume weighted average price (“VWAP”) for the day, provided, among other things, that the security has an average daily trading volume (“ADTV”) of at least $1 million, the trade is entered into before the opening of the market, and the purchase does not exceed 10% of the ADTV for the security;
- Whereas failure to meet the conditions of the Rule with respect to any purchase on a given day currently disqualifies all the issuer’s purchases during that day, the Rule would be amended to provide that failure to comply with the pricing condition solely because of a “flickering quote” would disqualify only that purchase; and
- The merger exclusion, which generally bars reliance on the Rule following the announcement of a stock merger or similar transaction until the target shareholders have voted, would be extended with regard to a special purpose acquisition company (“SPAC”) until both the target shareholders and the SPAC shareholders.

The SEC is seeking comment on the proposed changes and on an additional exception the SEC is considering but has not yet proposed, for purchases made using alternative passive pricing systems. The SEC has also asked for comments on a number of specific questions relating to the operation of Rule 10b-18.”


(click [here](#) for article)

This is practitioner’s regulatory update on the November 2003 amendments to Rule 10b-18. The short release discusses the three key aspects of the amendment: (1) new disclosure requirements, (2) modified treatment of block repurchases, and (3) new treatment of repurchases pending certain M&A transactions. Other amendments include modifications to the time, manner, volume, and price conditions to bring the specifics of those conditions up to date with current market size and practices. The new disclosure rules were generally a response to investors wanting to see whether companies repurchase shares and how they do it. The changes to the treatment of block trades and repurchases pending M&A transactions limit the safe harbor’s availability.
The disclosure amendment requires companies to disclose all repurchases of equity securities registered under Section 12 of the Exchange Act, regardless of whether the repurchases are made within the Rule 10b-18 safe harbor. The history of proposed Rule 13e-2 (would have required disclosure and would have been a prohibition on repurchases under certain conditions, not a safe harbor) is discussed as background for disclosure and repurchase programs. Item 703 of Regulation S-K (and corresponding forms: 10-Q and 10-K) require the disclosure and is independent of Rule 10b-18 (see note 2 to Rule 10b-18). The author notes that companies are also required to disclose material repurchases in the MD&A. Specific types of transactions besides open market transactions requiring disclosure under Item 703 are discussed: Private repurchases, particularly “accelerated share repurchase programs” and “option transactions” relating to part of publicly announced repurchase plans. The article notes that it is unclear whether disclosure under Item 703 is required for repurchases under employee benefit plans. Each condition (manner, price, timing, and volume) are discussed and the purpose of each condition and any amendments is described.(pp. 21-22).

Before the amendment, block transactions were not subject to the 25% ADTV volume restriction, and they were subtracted from the ADTV when calculating the 25% limit for non-block purchases, so firms were able to make unlimited block repurchases while complying with the safe harbor. The amendment requires block purchases to comply with the 25% limit except for those purchases falling under the “one block exception,” which allows a company to make one block purchase each week, regardless of size, if no other Rule 10b-18 repurchases are made that day. Those purchases are excluded from the four-week ADTV calculation.

For repurchases pending a merger or acquisition, formerly repurchases were excluded from safe harbor eligibility if they were made “pursuant to a merger, acquisition, or similar transaction involving a recapitalization.” Under this rule, companies thought that this merger exclusion only applied to repurchases made as part of the transaction and that the exclusion did not apply to repurchases made outside the terms of the transaction. The amendment deleted the phrase “pursuant to” to restrict the use of the safe harbor during the pendency of a merger or acquisition. Now the safe harbor is not available for repurchases made following the public announcement of a transaction till the earlier of the closing of the transaction or the vote on the transaction by the target shareholders. (see “Wachovia merger” article). There are two exceptions that are discussed—merger exclusion doesn’t prohibit use of safe harbor for purely cash transactions where there is no valuation period and it doesn’t apply after the announcement of a transaction if repurchases meet certain volume requirements.

The overlap between Regulation M and the amended version of the merger exclusion of Rule 10b-18 is discussed. (p. 23). Although the safe harbor has always been unavailable for repurchases during the restricted period under Regulation M, the modified merger exclusion makes the safe harbor unavailable when the merger or acquisition is announced, which is earlier than before. Also, unlike Regulation M, the modified merger exclusion does not appear to be limited to repurchases of the stock of the acquiring company—at the announcement, the safe harbor would be unavailable for repurchases of target stock by the target and by the acquirer if it is an “affiliated purchaser” of the target. The author concludes: “As a result of the new merger exclusion, companies with an active M&A program may find themselves in overlapping periods where Rule 10b-18 is unavailable or only partially available based on pre-announcement...
repurchase activity. A company in such circumstances may want to consider whether repurchasing within the standard 25 percent volume limit (but in excess of its actual daily average (repurchases over the preceding three months) would have a manipulative effect on the trading prices of its shares.” (p. 23)
7. Articles

a. Law Review Articles

**Adolf A. Berle, Stock Market Manipulation, 38 COLUM. L. REV. 393 (1938).**  
(HeinOnline Link, subscribers only – click here)  
This short article, written not too long after the passage of the 34 Act (but before rule 10b-5) discusses how the 33 Act and 34 Act manipulation provisions codified the common law approach to manipulation (as a form of fraud or deceit): “The history to date of the actions based on stock manipulation appears to demonstrate the soundness of the theory that the substantive law is still the common law, though the procedure is energized by the recent federal legislation.” (p. 401) Cases were being brought against market manipulators under the common law and the Mail Frauds Act. It actually points out that, in some ways, the common law was broader than the statute, particularly Section 9, since Section 9 of the 34 Act did not apply to over-the-counter securities as the common law did. In addition to common law roots, it discusses state statutes, such as the NY state manipulation law in 1931.

**Harold S. Bloomenthal, The Case of the Subtle Motive and the Delicate Art—Control and Domination in Over-the-Counter Securities Markets, 1960 DUKE L.J. 196 (1960).**  
(HeinOnline, subscribers only – click here)  
This article from 1960 is, at this point, largely a historical perspective about manipulation in the over-the-counter market and how the SEC regulates in that area. It uses a narrative of over-the-counter transactions to assess how they can be regulated to allow market making but prevent manipulation. The narrative involves potential violations of Sections 10(b) and 15(c)(1) of the 34 Act and Section 17(a) of the 33 Act. Since Section 9 only applies to securities listed on national exchanges, that provision is not discussed. The discussions of when market making crosses over into illegal manipulation, and how disclosure can counteract some of the unlawful activities, is recounted using examples. The article concludes that the SEC needs to be aware of exactly which type of activities it should be regulating and promulgate rules that balance allowing the dealer to be a market maker with preventing manipulation. The SEC should focus on rule-making to make it clear to dealers what conduct is prohibited, and it should not attempt to “regulate” through its adjudication powers. If the SEC takes a rule-making approach, the article offers different tactics it could take to combat over-the-counter manipulation, including: (1) a “disclosure” remedy requiring the dealer to disclose that he is the principal or the only market in a particular security, (2) an “absolute prohibition” preventing a dealer making a market from buying and selling the same security in the retail market, something in “between” 1 and 2.

**Harold S. Bloomenthal, Market-Makers, Manipulators and Shell Games, 45 ST. JOHN’S U. L. J. 597 (1971)**  
(HeinOnline, subscribers only – click here)  
This article was a call for reform to the SEC asking the commission to more aggressively regulate dealers/market-makers who engage in “manipulative” behaviors. Although the article discusses “traditional” (Section 9 and Rule 10b-5) manipulation schemes, it engages in a lengthy discussion about how the SEC should regulate dealers in the over-the-counter market in terms of rules for access to secondary markets, segregating the retail and wholesale phases of the OTC market, and establishing a public corporation “which would provide a marketplace for
unseasoned securities until such securities are ready to graduate to established markets.” (p. 642). It criticizes the SEC for thinking disclosure is the antidote to problems with market-makers. Much of this article is out of date (focuses on study of dealer market when it was made up of 4,500 dealers, see p. 598; article says that a new system of quotes for OTC was about to be launched, pp. 600-1), but might offer a good analysis of problems with pure dealer markets when left with little regulation.


This recent article written by practitioners is about the 2008 financial crisis. The relevant part of the article is about short selling (pp. 253-59). It doesn’t add much to the other sources on manipulative short selling, but it does give some examples regulatory actions, such as the July 2008 announcement by the SEC Office of Compliance, Inspections and Examinations (“OCIE”), FINRA, and NYSE Regulation, Inc. that they would conduct investigation aimed at the intentional spread of false information. (p. 256). It notes, however, that regulatory actions for short selling are rare because of the intent hurdle. (p. 256). The article discusses one case, involving a trader at Schottenfeld Group LLP, who was charged with securities fraud and manipulation. (pp. 257-58). The trader sent instant messages to 31 securities professionals in a 5 minute period claiming that the board of the company of the stock at issue was meeting to consider a reduced buyout offer. (p. 258). The case settled probably because it was so easy to prove with the instant messages and trading right after they were sent. (p. 258). A discussion of the ban on naked and legal short selling is undertaken, showing how harmful it ended up being in retrospect. (p. 259)


This article was co-written by a law student and practitioners. It mainly discusses how naked short selling works and the harm that it does. The article does not add too much to the other articles on the same subject but does offer the most technical explanations about how the clearing and settlement structure is taken advantage of so that manipulative naked short selling occurs. It discusses Overstock.com and other firms that have been involved in manipulative naked short selling schemes, but does not discuss death spiral financing per se.


This article was cited in the Cox, et al, case book. It is an empirical study of Rule 10b-18 compliance using privately disclosed data. Looking at 54 firms, although overall compliance was high, only two consistently complied with the safe harbor requirements for all repurchases in their program, despite public statements of compliance. The article breaks down the statistics on non-compliance by each condition in Rule 10b-18. The violations are more likely to occur after price declines.
The article tracks the historical regulation of repurchase programs from the SEC v. Georgia Pacific case (S.D.N.Y. 1966) and the proposed Rule 13e-2. (p. 292) Proposed Rule 13e-2, proposed in 1970 and revised in 1973 and 1980, would have imposed prohibitions and disclosure requirements. Instead of enacting it, the SEC did a “regulatory about-face” with the Rule 10b-18 safe harbor. (p. 293)

The authors criticize Rule 10b-18 for not linking the safe harbor with disclosure requirements, as Reg D/Form D and Rule 144/Form 144 does. (p. 293) Without these corresponding disclosures, the authors argue that Rule 10b-18 conformity is almost impossible to monitor. (p. 293) but this is no longer true, since 2003 amendments require disclosure under Item 703 of Regulation S-K for Section 12 securities.

The article also notes the lack of 10b-18 cases, noting: “There have been no lawsuits or other actions taken by the SEC regarding manipulative behavior surrounding open market repurchases since the adoption of Rule 10b-18.” (pp. 290-91, as of 2003).


Generally, this short article focuses on how globalization has challenged the way U.S. security laws are structured. In Part II of the article, “The Too Big to Fail Approach to Securities Regulation,” the author summarizes the SEC approach to big issuers versus smaller issuers. For example, exemptions in Regulation M apply to issuers with a public float of $150 million and whose ADTV is at least $1 million. The stabilization rules in Reg M do not apply to foreign purchases complying with the requirements of the foreign market. The author finds the foreign exemption important: “The most significant policy implication of Regulation M is the SEC’s willingness to defer to the regulatory safeguards provided by other markets. The SEC's deferral in Regulation M to the transparency of the market in which a security trades, and the likely enforcement surveillance efforts of that market's officials, as well as recognizing the regulatory demands applicable to off-shore stabilization efforts that will influence the price in all markets for global offerings, are important deregulatory steps by the SEC. As the SEC grows more comfortable with its new deference to both sister country regulatory requirements and the greater visibility with which the largest issuers conduct their business, we may well find similar deference with disclosure-based issues, a subject examined below.” A historical review of the treatment of global offerings is also undertaken: “SEC's long-standing position has been that its distribution rules applied as well to global offerings, provided a tranche of the offering was within the U.S. This posed serious problems for market making activities of foreign distribution participants because many foreign exchanges require market makers to stand ready to buy and sell securities at all times." Since a security's major market makers are logical, if not necessary, participants in any global offering, any of its securities, a strict application of the SEC's distribution rules posed serious conflicts for such participants with their local market making responsibilities. On the other hand, the trading, and potential artificial impact, in a foreign issuer's home market by its local market maker raised questions whether U.S. prices for that issuer's securities would be similarly artificially supported.” (p. 13). The overall tone of the article is that there has been a shift in the SEC’s approach to globalization: up until the time the article was written, the SEC protected the U.S. markets from potential problems with foreign securities bought and sold in
markets with less protective securities laws, but recently (around 2000), there is less protection from problems with foreign issuers and markets.


(available at msu.edu – click here)

This article by a law firm associate reviews short selling regulations through 2008. It discusses manipulation and short selling in the end of the article because it suggests that investors who sell short are more vulnerable to manipulative schemes (through the “short squeeze, whereby “the price increases to levels at which short sellers can no longer accept the heightened risk of loss, thus forcing short sellers to buy in the open market to cover their position.” p. 155) than “long buys.” (p. 137). It suggests the remedy is to allow widespread naked short selling to deal with asymmetries for cost and trading risks for shorts versus longs. (p. 137). The author argues that abusive naked short selling would be discouraged because of the anti-manipulation rules. (p. 154)

**Anthony De Toro, Market Manipulation of Penny Stocks, 17 SEC. REG. L.J. 241 (1989)**

(Article unavailable in electronic form)

This article discusses the same (then-proposed) anti-manipulative regulations relating to penny stocks as the Cox and Goldstein article. In contrast to the Cox and Goldstein article, the author, also a former SEC staff attorney, takes a critical approach to the regulatory efforts of the SEC. The article starts from the perspective that the public and private enforcement efforts against manipulation are inadequate and that no one understands how OTC stocks are manipulated or how the regulations work. After describing the framework for manipulation cases in the OTC market, it offers tips for practitioners involved in market manipulation cases (including how to obtain circumstantial evidence to show manipulative purpose, p. 255). NASD (now FINRA) rules are important in this area, since most brokers dealing in penny stocks are registered with NASD. The author describes why the OTC market is particularly susceptible to manipulation schemes because stock price quotes in “pink sheet” market are thinly traded. (p. 246) Also, the pink sheets do not indicate number of shares the market-maker is willing to buy or sell. (p. 246). Finally, the “float” is smaller and easier to control (so that “demand must be satisfied from an artificially small supply of free trading stock. The effect is to cause market demand to have a disproportionate impact and the stock price is artificially driven up.” (p. 250).


(HeinOnline, subscribers only – click here)

The authors assert that the problem with “manipulation” is that it has no definition—it is not defined in the securities acts and there is no good definition from courts or the academy. It is misused to refer to fraud or monopoly or otherwise it is used to trading made with “bad intent.” Authors suggest why all three traditional expressions of manipulation (interference with free play of supply & demand, inducing others to trade, and forcing security prices to artificial level) are insufficient. In the alternative, they suggest that the whole concept of “manipulation” be abandoned and fictitious trades should be analyzed as species of fraud. Actual trades should not be prohibited as manipulative regardless of intent of trader. Manipulation is self-deterring, because it is not profitable, so no need to regulate it.
Relevant to manipulation, breaks down types of manipulation and how shorts selling can be employed in manipulative scheme (i.e. to move price without info, away from fundamental value)

Manipulation categories described:

1. “pure manipulation” – depressing price and repurchasing
   a. Manipulator has no information that stock is overpriced, but sells short a large block of shares knowing that price will be driven down, then repurchase at lowered price
   b. Example is “bear raids” of the 1930s

2. “Depressing Price in order to Profit on a Third Party Contract”
   a. Context: contracts providing one party with a payoff depending on market price of issuer’s share at a specific time. Payor party (high price beneficiary) desires the price to be driven down at time of payout but payee (low price beneficiary) would like it to be higher. So before payout time, low price beneficiary could sell short a large block of shares to drive down the price to save money at payout time.

3. False-news related manipulation (“false news spreading short sellers”) (Prosecuted under 10b-5’s prohibition against making “any untrue statement of material fact . . . in connection with the purchase or sale of security) (cf. other kinds of insider trading where insider is trading on inside information that is true, such as short selling on basis of negative inside information, p. 22, which moves price in more accurate direction, and is therefore socially beneficial because it improves share price accuracy)
   a. Strategies (p. 17)
      i. Sell short, spread false negative news thereby depressing price, cover at lower price
         1. Ex) See FN 25 re SEC v. Paul Berliner (litigation release shows settled suit was brought under 10b-5 and also 9(a)(4), which only applies to broker-dealers, among others)
      ii. Spread false positive news thereby driving prices up, short sell at inflated price, cover after market realizes news is false and price depresses
   b. Strategies for profiting from spread of false news without involving short selling (p. 19)
      i. Spread false negative news, purchase shares at now depressed price, resell after market realizes news is false and price rises
      ii. Purchase shares, spread false positive news, sell at now inflated price

(Available on SSRN – click here)
The main impetus for the article is that the authors felt that there was a need for a unifying “general theory that explains securities regulation as a whole. “ (p. 714). Mainly it codifies law and economics concepts—who should regulations protect (conclusion here: information traders) and what the policy implications are of that recognition (here, four conclusions: (1) mandatory
disclosure system is best and (2) that should not be limited to hard information and management self-dealing, (3) the FOTM theory should apply even where markets are inefficient, and (4) the standard of care in misstatement cases should be negligence not fraud. (pp. 713-720). In the section discussing manipulation (and fraud), the authors discuss how restrictions of fraud and manipulation lower the cost information traders would otherwise have to pay to verify information and thereby this allows them to make more accurate price predictions. (p. 716). The authors assert an allocative argument: “Absent restrictions on fraud and manipulation, all information trader would expand resources on verifying the same pieces of information. Of course, such duplicative investigations would be socially wasteful.” (p. 741). The authors offer a way of thinking about manipulation not as a manipulation of price but in a way, as a manipulation of information: “The ban on . . . manipulation . . . reduces verification costs, because . . . implicit information cannot be manipulated.” (p. 741). This, in turn, creates a virtuous cycle” where more informed traders can participate and there is greater competition. (p. 743). They also offer that criminal sanctions would be the best way to deter manipulative behavior, since civil liability based on actual damages would result in small damage awards and fraud is difficult to detect. (at pp. 741-42). The authors also discuss how restrictions on fraud and manipulation “also lower the risk associated with capturing price-value deviations.” (p. 742). Because there is a risk of misstatements, information traders invest in precautions to discover them and also risk losing the price-value deviation to noise traders “who relied on the price distortion” (p. 742). Additionally, these restrictions protect the analysts’ products and reputation. Analysts often do not trade and just sell their analysis to others, so they can’t sue because they did not trade or rely on the misstatement. (p. 742). Investors will not buy the analysis if it proves not to be valuable because it didn’t account for skewing of price by manipulation. Finally, the restrictions improve liquidity because they “reduce the frequency of misstatements and consequently lower the risk of asymmetric information for market makers. This, in turn, will lead market makers to lower the bid-ask spread. Lower spreads will result in higher liquidity, lower cost of capital, and improved efficiency.” (p. 743).


This short article, by two then-SEC attorneys, discusses the opportunities for “manipulation” in the penny stock market. Article defines “penny stocks” as “low priced equity securities traded in the U.S. over-the-counter (OTC) market.” (p. 676). The article discusses “manipulative schemes” including: “selling to nominee accounts to artificially support the price of the stock; allowing insiders to sell at inflated prices; making false representations about a company whose stock a firm is touting; and churning customers’ accounts.” (p. 676). The main focus of the article is mark-ups and the NASD rules that regulate them. It also discusses how the then-recent Penny Stock Task Force (SEC) and the Penny Stock Task Force changed the regulatory landscape by requiring more disclosure of pricing information and permitting the remedy of disgorgement. The only specific discussions about “manipulation” in terms of 10(b) and 14(e) is pages 690-91, where the authors discuss failure to disclose excessive mark-ups as a 10b-5 violation. Analogizing to the Santa Fe and Schreiber cases, it suggests that if full disclosure of mark-ups, even excessive ones, might immunize a market maker from liability. But it notes that the NASD rules make excessive mark-ups illegal regardless of disclosure.

(HeinOnline, subscribers only – click here)

The article calls for IPO regulation reform and has a section on laddering which cites to relevant additional authority: *In re Initial Pub. Offering Antitrust Litig.*, 287 F.Supp. 2d 497, 519-23 (S.D.N.Y. 2003)—not same opinion as is in this bibliography: discusses how SEC has proposed regulating this in Proposed Rules 10b-20 and 10b-21, and amendments to Rule 171-3(a)(6) and (7) under the 34 Act. (see p. 751, note 226)


(HeinOnline, subscribers only – click here)

This article contrasts Rule 10b-5 manipulation cases with Rule 9(a)(2) manipulation cases. It provides helpful comparisons of elements, but cases are obviously outdated. It also develops a categorical approach to manipulation claims, breaking down manipulative schemes into: fictitious transactions, manipulations involving real transactions, misrepresentations and rumors, manipulation by broker-dealers. (page 515). It discusses several schemes that are hard to categorize, such as: “1) limiting the supply of a security; 2) agreeing to purchase a security without intending to pay for it; 3) mismanaging a corporation to affect the price of its securities; 4) engaging in certain acts during tender offers, exchange offers, mergers, or acquisitions; and 5) activities by broker-dealers.” (page 546). This framework is helpful to organize the different types of schemes and claims under Section 9 or 10(b).

It also discusses several Section 9(a)(1) wash sale and match sale cases from the 1930s-1970s and how courts deal with those types of claims. The article makes a good point about the differences in proving intent in cases employing fictitious transactions and those that involve bona fide trades/“real transactions”: “economic justification can rarely be found for fictitious trades. Therefore, although intent must be show, the requisite purpose can be inferred from the absence of an adequate explanation for the trades, coupled with an economic incentive to move the market price.” (page 519). The author engages in an extensive comparative discussion of Section 9(a)(2) and Section 10b-5 manipulation schemes where there is a “real transaction.” (pages 520-526). The article also discusses the intent/purpose requirement under Section 9(a)(2) (“for the purpose of inducing the purchase or sale of [the manipulated] security by others”) and how it can be proven using circumstantial evidence.


(HeinOnline, subscribers only – click here)

This article focuses on death-spiral securities fraud litigation, but it was written in 2004, which makes it slightly outdated—importantly, the ATSI case had not been decided. It looks at six death spiral lawsuits (5 are district court cases, mostly from the SDNY, and one is the Third Circuit’s GFL Advantage) and evaluates the claims in terms of 10(b) claims for misrepresentations/omissions or manipulation (but does not consider Section 9 manipulation). It discusses whether naked short selling should be found by courts to be per se illegal (this author thinks it should) and Regulation SHO. It talks a lot about the types of companies that issue these
securities, who buys them, and how the regulatory framework impacts the rules applicable to each case, since the SEC rules regulating short selling do not apply to OTC stocks. It also talks about specific features of short selling logistics: locating and delivery standards and margin requirements (p. 369) in more detail than other articles. In examining several district court cases involving death spiral financing, the article groups the types of 10b-5 claims into two groups: (1) misrepresentations and omissions versus (2) manipulation claims. This division tracks the information based versus trade-based manipulation claims, but the author was going off of filed complaints not actual cases (p. 392). (pp. 390-91, 398-410). The “information-based” claims are based on the plaintiff issuer claiming that the defendant purchaser misrepresented his intention as to short selling. (p. 400).

The article also engages in an extensive discussion of the GFL Advantage case and the Sullivan & Long case (starting on p. 393). Court finds that you can extend GFL Advantage’s logic and conclude that the court would support a rule that naked short selling is manipulative, even though the court in that case found that the short selling was not manipulative. (p. 413). Naked short selling could be viewed as a manipulative device/ the “something more” the court in GFL was looking for to find the conduct manipulative. (pp. 413-14). Sullivan & Long found naked short selling not to be manipulative, but the author sees this as consistent with his view that it is a manipulative device for three reasons: (1) the defendant did not violate any market rules in conducting its naked short sales, (2) the company in Sullivan & Long was large and the EMH applies, unlike usual death spiral cases, and (3) the defendant had “virtually perfect pricing information, which will rarely exist in the marketplace.” (p. 416). The article identifies other causes of action besides federal securities laws which could be used for death spiral litigation, such as state corporate law remedies, specifically restricting companies from issuing future-priced securities without receiving shareholder approval. (Although note that NASD Rule 4350 has such a shareholder voting requirement for NNM and SmallCaps issuing FPS’s convertible to at least 20% of issuer’s common equity, but this doesn’t apply to other OTC markets). (p. 427)


(HeinOnline, subscribers only – click here)

This is a general article on a behavioral finance approach to securities regulation. In the introductory material, the author reviews then-current debates about the EMH and the alternative inefficient market hypothesis (“IMH.”) It uses a few “Exercises” in “behavioral securities regulation,” including, relevant to manipulation, an examination of the Jonathan Lebed internet pump-and-dump scheme. The author identifies “overconfidence” a cognitive bias that drives investors to participate in such schemes. (see pp. 154-163). The section on Internet fraud provides a helpful summary of how the Internet changed the landscape for securities regulation because it provided a “…new communications medium for the dissemination of information and opinion about financial matters…,” and “and low-cost online brokers like Charles Schwab and Datek.” (p. 154). It offers a behavioral finance approach to looking at how the Internet posts affected market price and how to frame this as a causation issue in the legal case for these types of schemes: there were a significant number of “momentum traders” who jumped on the bandwagon of the scheme, not because of Lebed’s “pumping,” but because of all the activity in the stock generated by the response to the pumping.
The article summarizes the Ross and Fischel/Thel debate (pp. 160-61) about whether manipulation is self-deterring. It comments that Ross and Fischel’s thesis that manipulation is self-deterring depends on assuming the stock is widely traded and that the EMH is strong. Behavioral finance offers another take: “Behavioral finance gives ample reason to suspect that trade-based schemes can succeed by triggering positive momentum-trading activities by others.” (p. 161). The author discusses the Markowski/Mulheren debate, through behavioral finance lens: “Unlike fraud, manipulation is concerned less with the immediate victim than the integrity of the market. To be sure, this market integrity approach rings of what is a justifiably controversial theory in the law of manipulation: that it is unlawful simply to trade for a bad purpose, i.e., simply to move the stock price for some selfish motive.” When stretching a doctrinal construct like this, we do need to ask whether imposing an elastic standard will do more harm than good. Subjective intent is hard to fathom; why someone traded or said or did something is difficult to prove. Hence, attempts to convict a trader for trading with a bad purpose will lead to a high frequency of prosecutorial and judicial error. This, in turn, raises the prospect of chilling legitimate behavior.” (pp. 161-63). The article doesn’t offer any approaches to this question of Internet manipulations, but just simply points out how behavioral finance could be a helpful way to look at how these Internet pump-and-dump schemes are successful.


In this short article published by the North Carolina Banking Institute, the author criticizes the 2002 amendments to Rule 10b-18, particularly the elimination of the former “block exception” to the volume condition. As it was enacted in 1982, the issuer repurchase safe harbor allowed issuers to make block repurchases of their common stock. The author asserts that rule 10b-18 was amended in 2002 in the wake of the merger of Wachovia and First Union, which involved the use of a repurchase program to raise the price of the favored bidder’s (First Union’s) stock to make it comparable to the offer from a rival (disfavored) bidder, Sun Trust. The rule was then amended so that the definition of a “10b-18 purchase” excludes repurchases effected during the time period between the public announcement of a merger, acquisition, or similar transaction involving recapitalization, until the transaction was complete. In the Wachovia situation, First Union began repurchasing after it had announced the merger publicly, and now that would have been prohibited. Instead of stopping at that change, the amended version of the rule also eliminated the block exception to the volume condition. The SEC justified this change by stating that the exception “may allow issuers to dominate the market for their securities in a way not originally contemplated by the safe harbor” (p. 195, quoting SEC), but did not cite any evidence that since the rule was enacted in 1982, the block exception caused market manipulation. The SEC believed such domination could lead to misleading investors about the effectiveness of the market to gauge prices. The SEC relied on two studies that concluded block transactions affect share prices (see FN 139), but there was no evidence that this shows the effect was manipulative any more than other repurchases that affect market price.

The new rule allows repurchases to be made in smaller amounts over a longer period of time (which will raise transaction costs), and there is no evidence that the effect of this repurchasing strategy is any less manipulative. According to the author, the new rule favors large issuers over issuers whose stock is thinly traded because “the elimination of the block purchase exception
will preclude a community bank or savings association from repurchasing its shares.” (p. 205). Since federal law prohibits savings associations from issuing additional shares, the associations are entirely dependent on repurchasing to meet demands of stock option and incentive programs, especially since these stocks are not widely trading. (p. 204). As a result of the amended rule, the associations will be unwilling or reluctant to engage in the repurchasing because they have to comply with the more restrictive volume condition of the safe harbor. Repurchasing through block purchases was also a strategy used by issuers to reduce outstanding capital and thereby increase return to shareholder, something that banks who have become publicly traded companies had done.

The author cites two examples of companies who went public and engaged in block repurchases to reduce outstanding shares. Under the new rule, those companies would not have been able to reduce their capital levels in through repurchases in the same way while remaining within the conditions of the safe harbor. (pp. 205-06). There is a lot of detail about the old rule and how the block repurchase exception was used and a proposal that the rule reinstate the block exception to the volume condition or to define “block purchase” in the amended version to match the “block purchase” definition of the NYSE/NASD rules (which had thresholds that were twice that of the 10b-18 definition.) (pp. 209-10)


The main focus of this article is a critique of the bankruptcy case *Enron*, 333 BR 205 (S.D.N.Y. 2005), which held, for the first time, that “buyers of bankruptcy claims are now subject to equitable subordination not just for their own conduct but also for conduct of previous owners of the claims, regardless of whether the conduct was connected to the claims.” (p. 390). Among the flaws in this holding, the author identifies how this creates the possibility for market manipulation in claims trading. The manipulation could be achieved through a “short and distort” (opposite of pump and dump) scheme. This is how it would work: “A potential claims purchaser could easily manipulate the claims market to achieve a bargain purchase by putting out word of inequitable behavior by claims’ originator(s), who would themselves not be harmed unless they were still claimholders. A potential purchaser would not have to state any false facts; implications and suggestions could well do the job.” (p. 420). The author finds this claims trading context particularly well suited for the manipulative scheme: “While a “short-and-distort” stratagem is possible in all markets, it would be far more effective in the claims trading market. OTC markets like claims trading lack price stabilizers like specialists and market makers. Additionally, in a regular market, negative information about a security will cause the security’s price to fall, but it will not usually result in a cessation of trading. Moreover, negative information about a publicly traded company’s operations is usually verifiable: did earnings meet expectations? Did a clinical trial fail? Has a government investigation commenced? These are black-and-white questions. It is much harder to answer whether a company acted so inequitably that its claims will be subject to subordination.” (p. 420)

This is particularly problematic because it would leave the “victim” of the manipulation scheme without legal redress because federal or state securities laws have not been applied to bankruptcy claims trading (at least this was true at the time this article was published, and a cursory search I
did confirms that this is still true). (p. 420). (Also, equitable subordination and claims disallowance would not work as remedies. (p. 420)).

**Lewis D. Lowenfels & Alan R. Bromberg, Securities Market Manipulations: An Examination and Analysis of Domination and Control, Frontrunning, and Parking, 55 ALB. L. REV. 293 (1991).**

(HeinOnline, subscribers only – click here)
The overall theme of this article is that in order to advise your client about navigating anti-manipulative laws, one must take into account the 34 Act, 33 Act, the regulations promulgated under the federal securities laws, SRO rules, and the administrative and judicial interpretations of those statutes and rules. The article examines this patchwork of regulations and interpretations in three contexts: (1) “domination and control,” (transacting in a large percentage of a particular security within a specified time); (2) “frontrunning,” (trading in possession of insider information about an imminent block transaction that will affect price); and (3) “parking” (generally, selling securities subject to an agreement that they will be repurchased at a later time at a certain price). For each topic, the applicable law is reviewed. There are also overarching points made for each topic: (1) “domination and control” cases must be analyzed in the context of the total trading activity for the period of alleged manipulation, because courts are not comfortable finding illegal manipulation only based on domination and control; (2) “frontrunning” is not defined by the securities laws or courts, so one must look to the SRO interpretations; (3) “parking” is best defined by case law, and the definition changes with each context in which parking is found.


(HeinOnline, subscribers only – click here)
This short law review article focuses exclusively on the two subsections of Section 9. The impetus for the paper seems to be that there was a lot of litigation under Section 10(b) and Rule 10b-5, and “it is important to emphasize that there are other statutory provisions which, depending upon the particular facts and circumstances, may prove useful in curbing such activity.” (at 713).

For Section 9(a)(1), the article offers some quotes about why there has been less Section 9(a)(1) litigation: “The “purpose” requirement of Section 9(a)(1) (in contrast to the Section 9(a)(2) “purpose” requirement discussed below) has not engendered a great deal of litigation probably because, except for transactions effected to realize capital gains and a concomitant higher cost basis for tax purposes or the legitimate crossing of orders pursuant to exchange rules, “the only likely ‘purpose’ of engaging in wash sales and matched orders is to falsify the market.” Congress took some care to specifically prohibit “wash sales” and “matched orders” in the 1934 Act because in 1934 this form of manipulative activity was regarded as “the most vicious practice of the stock exchanges . . . on a par with the use of loaded dice . . . however, more reprehensible.” (at 699). Also, regarding 9(a)(1) matched order claims: “Perhaps this dearth of authority has resulted because wash sales are shunned by manipulators as relatively crude and blatant, as easy to detect by the regulators, and as difficult to defend on the basis of legitimate business purposes.” (700). There is one case from 1976 that the author pulls a long quote from to describe how
matched orders and wash sales could be effected in a more contemporary environment (Michael Batterman, discussed through litigation release). (at 703-05).

For Section 9(a)(2) claims, the article discusses how they apply to exchange-registered securities manipulated on the OTC markets. (at 706). It also goes through each of the three elements that must be proven to establish a violation under this section. (pages 707-713). Particular focus is on the third element “manipulative purpose” (“the purpose of inducing the purchase or sale of such security by others”) and how inferences can be used for proof of this state of mind. (p. 711). (In this section, author discusses Crane Co., Resch-Cassin, etc).

**Paul G. Mahoney, The Exchange as Regulator, 83 VIRGINIA L. REV. 1453 (1997).** (JSTOR, subscribers only – click [here](https://www.jstor.org/stable/1117798))

This article focuses on the idea that the exchanges would have been better regulators than the government, and contains a short section on manipulation (pp. 1470-73). This section discusses how there is little evidence that the “pools” of the 1920s were “manipulating” prices in was that the 34 Act eventually proscribed. (For example, the term “wash sale” was used “in the sense tax lawyers used it—a purchase followed promptly by a sale, or vice versa—rather than to refer to a fictitious trade.” (p. 1473)). Specifically, the section on manipulation discusses information-based manipulation and trade-based manipulation through corners and squeezes.


This is a law student Note about pleading requirements for manipulation claims. It outlines how the PSLRA was enacted to deter “strike suits” by plaintiffs’ attorneys with weak claims forcing defendants into settlement. It then outlines how state laws regulating manipulation were affected: “In response, Congress passed the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") to stop the movement to state courts. The SLUSA preempted state law causes of action for securities fraud and market manipulation and made securities class actions brought in state courts removable to federal courts. Thus, Congress slammed shut the state court back door.” (p. 764). The main point of the Note is that litigants have an incentive to frame their claims as manipulation claims (instead of fraud claims) because they circumvent the higher pleading standards: “Overall, the present pleading standards for market manipulation leave open a back door for strike suits, because the prevailing interpretations of the pleading standards for market manipulation are less stringent than the respective standards for fraud claims. Whereas the heightened pleading requirements of the PSLRA apply to the material misstatement or omission element of a securities fraud claim, 7 7 the relaxed interpretations of Rule 9(b) govern what plaintiffs must allege to satisfy manipulative conduct. Additionally, although fraud and manipulation claims are both governed by Rule 9(b) with respect to loss causation, they have been distinguished in a way that makes the pleading standard for manipulation less rigorous.” (page 784).

This law student Note is about death spiral financing. The one thing this adds to the Knepper articles is that it provides more analysis of how these claims fare when framed as Section 9 claims. There are no cases on point, so it just is a hypothetical discussion of how a typical toxic convertible claim would work as a Section 9 claim.


(available at arno.uvt.nl – click here)

This recent article adds to the “how to define” manipulation debate as set out by Fischel & Ross/Thel. The author introduces to this ongoing discussion new vocabulary to build his definition, including “price pressure,” which looks to “the individual contributions to the total price change” (p. 1178). “A trader exercises unsupported price pressure when he lacks sufficient information to justify the price pressure.” (p.1184). He defines manipulation as “exercising unsupported price pressure.” (p. 1183). He criticizes Fischel and Ross for offering a subjective definition (see text relating to footnotes 19-28). He asserts that a subjective definition is flawed on a practical and doctrinal level Practically, because a person with “bad intent” could be an informed trader moving price towards fundamental value and a person with “good intent” could transact in a way with a high amount of price pressure and move the price away from fundamental value; doctrinally, because they ignore the legal framework which requires an act and intent for behavior to be illegal and their definition focuses too much in intent. (see text relating to footnotes 19-28.) He evaluates his definition in terms of social welfare, concluding that “a trader who exercises unsupported price pressure may create societal costs, even when he does not profit from trading. Thus a prohibition on manipulation may discourage unsupported price pressure, and as such increase social welfare.” (pp. 1197-98). In his section on “policy implications” he discusses how a country with no anti-manipulation rules could design prohibitions, and also offers how his definition could be applied to regulating manipulation in the U.S. under Section 10(b)/Rule 10b-5 and Section 9(a)(2).

The article bridges the law and economics debates over the definitions because, while it offers a definition consistent with market microstructure analysis, it also considers this definition within the framework of current regulations and the general legal issues of crimes requiring an act and a mental state as well as issues of circumstantial proof.


(HeinOnline, subscribers only – click here)

This is law student Note mainly an empirical study about the SEC’s relaxation of Rule 10b-18 repurchase requirements. It concludes that the temporary relaxation of the volume and timing restrictions for repurchases bolstered stock prices of companies that took advantage of the relaxed standards and repurchased their shares. In general, the article describes the categories of issuer repurchases: open market, privately negotiated, fixed-price tender offers, and Dutch auctions. (pp. 566-67) and why issuers repurchase: when management believes stocks are undervalued and repurchase when it’s a good deal and to send a signal to encourage market that stock is doing well, when companies need their stock to support employee stock option and purchase plans, to provide cash flow by repurchasing as opposed to paying cash dividends, to
adjust debt-equity ratios, to deter a takeover attempt by decreasing available cash, encumbering itself with more debt, and driving prices up. (pp. 568-71). It also discusses the regulatory history of Rule 13e-2, which was withdrawn in 1982, and the eventual enactment of 10b-18 and relevant amendments to 10b-18 (including a 1998 amendment to timing condition initiated by the NYSE). (p. 573). The discussion of the post-September 11 emergency regulation begins on page 580 and chronicles the September 14 Section 12(k)(2) emergency order to ease the requirements in Rule 10b-18. (pp. 582-3). The order exempted repurchases occurring between September 17 and September 21 from complying with the time and volume restrictions in Rule 10b-18. (p. 583). On September 21, the emergency order was extended till September 28 and then the SEC issued an exemptive order under Section 26(a)(1) relaxing the conditions for repurchasing that occurred from October 1 through October 12. (pp. 585-85). The empirical analysis describes various companies in different sectors of the economy and the success of their repurchase programs on stabilizing prices after September 11 (pp. 586-600). The companies that announced stock repurchases had lower abnormal returns than their counterparts who did not repurchase on September 17-19. (p. 600). The article generally praises the SEC for its actions during this time period. (pp. 601-02).

(HeinOnline, subscribers only – click [here](http://example.com))

This comprehensive article was written in the wake of the Supreme Court’s Schreiber v. Burlington Northern, Inc. decision and defends the Court’s interpretation of anti-manipulative provisions (10(b) and 14(e)), which was that manipulation cannot exist without misrepresentation or nondisclosure. The author asserts that this is consistent with other anti-manipulative provisions (including Section 9). The author specifically discusses manipulation in the context of corporate control transactions, including mergers, tender offers, and “going private” transactions. He also explores the intent requirement for Section 10(b) (and 14(e)) at a time when that was less discussed by the circuit courts. In the intent discussion, he splits manipulation down into trade-based and non-trade-based and then discusses how the intent requirements are different under each. He also engages in an extensive discussion of how the intent requirement under Section 9 differs from the other provisions and yet how the case law, across the board, requires “deceptive” acts and what that means.

**Powers, Michael R., Schizer, David M. and Shubik, Martin, “Market Bubbles and Wasteful Avoidance: Tax and Regulatory Constraints on Short Sales” (March 2003).**  
(Available on SSRN – click [here](http://example.com))

This 2003 article about short selling regulation has been somewhat made obsolete by the recent amendments to the short selling rules. It was written in the early 2000s, in reaction to the end of the “tech bubble” and offers the perspective that if the US made it less costly for investors to “bet against the market” by short selling then those sophisticated investors could have used “pessimistic” techniques to police the market. It criticizes the economic literature on short selling, which the authors say “mischaracterizes” and sometimes omits short selling constraints and does not discuss strategies for circumventing the constraints. The authors offer that the constraints on short selling to prevent market manipulation and panics could be a good thing, but that the regulations are poorly tailored to achieve those results.
The article discusses how short selling on a large scale can depress the price and how that when it is coupled with manipulative intent, that is the only time we consider it manipulation (versus if the price were too high to begin with). (p. 17). Manipulators can use false rumors to move the price. (pp. 17-18). The authors point out that this manipulation is achieved without short selling, so the proper regulatory response would be to target all manipulative trading, without “singling out” short sales. (p. 18). It offers suggestions for how to deal with manipulation, including maintaining the current regulations against manipulation with fraudulent information and for larger trade-based manipulation, offers a disclosure rule:

“We have acknowledged that market manipulation and noise traders offer a rationale for regulating both shorts and longs. While this problem is not the focus of this Article, we offer a few tentative suggestions. First, existing limitations on fraudulent misstatements are still needed to keep investors from shorting (or buying) and then spreading false rumors to influence the price. At the same time, other safeguards may address the separate manipulation concern discussed above: the ability of a large short sale, by itself, to depress the price and prompt momentum traders to sell. For one thing, this concern does not arise for smaller trades, and so a legal constraint is needed only for short sales that are large enough to move the market. For these large positions, one response is to require disclosure. For example, anyone shorting more than a minimum percentage of shares could be forced to disclose, in a statement issued within a brief time period after the short sale, information including (1) the fact of the trade, (2) their identity, and (3) their reason for shorting the stock. Other market participations could then assess whether the short sale derives from a desire to manipulate prices, or from solid information, in which case others would follow the short seller’s lead but a decline in the market price would be socially desirable.”

(p. 44)


After the 2004 amendment requiring disclosure of repurchasing programs, this author tracked 365 repurchase programs announced in 2004 to test whether these announced programs actually occurred. The author concluded that issuers were more likely (80.3% versus 62.6% average) to complete their repurchases after the disclosure requirement came into effect. The article discusses how the ex-post quarterly disclosure statements work (pp. 4-5). In introducing the background on repurchases, it documents how share repurchases grew from 6.6 billion in 1980 to almost $200 billion in 2000. (p. 6). Most of the article is about repurchases as a corporate finance strategy and not specifically about the risk of manipulation, but there is a section on manipulation and the Rule 10b-18 safe harbor (pp. 15-16). It points out that “Neither Section 9(a)(2) nor rule 10b-18 apply to repurchase announcements—they only apply to actual repurchases. The false signaling hypothesis postulates that firms seek to drive up the price of their stock by announcing repurchases they do not intend to complete. The bargain repurchases hypothesis suggests that firms announce some repurchases they do not intend to complete in order to confuse the market and minimize the price spike that follows repurchase announcements, thereby facilitating the repurchases at favorable prices. Such manipulation is not covered under Section 9(a)(2).” (p. 16 and p. 16 n. 58).
(Article unavailable in electronic form)
These authors were SEC attorneys at the time this article was written. This article mainly focuses on manipulation cases involving the Internet, but it starts out with a general overview of the relevant law. The authors describe how these schemes typically evolve: “In the typical case, individuals will begin to accumulate shares of a thinly traded over-the-counter bulletin board stock. They then create a buying frenzy by disseminating the stock price through mass unsolicited e-mail (known as ‘spam’) or through a web site. To varying degrees, the spam will include information describing why the time is right to buy or sell a particular stock. When the recipients of the spam start buying the stock price begins to run. The manipulators then dump their shares, realizing a quick profit. The share price inevitably tumbles when the market realizes there was no real justification for the run-up in the first place. All this can occur in as little as one hour.” (p. 237).

(available at www.nyu.edu—click here)
This is the most recent law review article on naked short selling. It explains how it works, controversies surrounding how often it is occurring, and how there have been no effective regulations or remedies (through enforcement suits) to curtail the problem. The article summarizes the case law on short selling (Sullivan & Long, 7th Cir. And GFL Advantage Fund, 3d Cir.) and how no federal court has said naked short selling is per se manipulation and therefore illegal. It also discusses how an investor accomplishes a naked short sale and how the mechanisms of the Depository Trust & Clearing Corporation (DTCC) and their issuance of “fails to deliver” (FTD) is exploited by the naked short seller. In its discussion of federal court litigation, it discusses the problems litigants have had in bringing cases against defendants for naked short selling. These claims can be framed as manipulation claims or misrepresentation claims. (pp. 15-16). In the manipulation case summaries, the article goes through the Circuit court cases of GFL Advantage (3d) and Simpson v. AOL (9th Cir.) and Sullivan & Long (7th Cir.). It reads Sullivan & Long as saying that naked short selling is not intrinsically manipulative under Section 10(b) (but notes that one scholar has pointed out that the court might have reached a different conclusion if there was evidence that the defendant violated a “market rule or equitable trading principle.” (pp. 16-17). The article goes on to other litigation hurdles a private plaintiff faces, such as standing and enhanced pleading requirements under PSLRA. (p. 18) The author discusses trends in naked short-selling, especially hedge funds suing brokerages: on antitrust grounds (pp. 39-41), claiming technical violations of trading rules (p. 42), or under state law (pp.44-45) but not “pure” market manipulation claims. The author describes Regulation SHO, including the parts that were repealed after it was enacted in 2004, and how it aims to reduce failures to deliver. (pp. 45-47).

(HeinOnline, subscribers only – click here)
This article is a direct response to the Fischel & Ross article. It rejects their article’s conclusions that lack of a definition is problematic and also that manipulation is self-deterring. The lack of a
precise definition in the Acts was prescient—this scheme allows SEC to quickly react to new inventions of manipulation when they emerge. Manipulation is not self-deterring because traders profit from moving prices and do so. Manipulation is hard to observe and prove, but doesn’t mean it’s not going on.


This was written in reaction to Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985), the case which limited 10b-5 (and SEC authority under 10(b)) to regulating manipulative conduct that is “deceptive.” Starting from a historical perspective of the Exchange Act, Professor Thel examines the meaning of “manipulative” in Section 10(b) (not Section 9) and concludes that it should be reexamined in the true goal of the statute, which is making sure securities are accurately priced, a goal that is broader than disclosure. Assuming the goal is price accuracy, Section 10(b) could be read to allow the SEC to regulate more broadly to include program trading, arbitrage, poison pills, stock-parking, and corporate abuses of control over dividend policy. While the argument of the article might be somewhat dated, the beginning of the article has a helpful historical summary of the history of the Exchange Act.

**Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 STAN. L. REV. 385 (1990).** *(JSTOR, subscribers only – click here)*

The author discusses how the “prevailing conception of 10(b)” differs from the “original conception.” The original conception, consistent with the language and structure of the Exchange Act is that it was meant to regulate any practice that might contribute to speculation in securities or move prices away from their investment value. The prevailing conception comes from court cases (about the scienter requirement: Ernst & Ernst, Santa Fe, Aaron…) which outline what activities are not subject to regulation under 10(b). The conclusions one can draw from these cases about what the Court deems manipulation are:

“If it is unclear just what is within the scope of the section, the Court has clearly stated what is not within the scope of the section by interpreting the section as encompassing two restrictions. First, section 10(b) reaches only knowing and intentional misconduct. Since a person violates section 10(b) only if he knows (or perhaps if he should know) what he is doing is wrong, careless conduct cannot constitute a violation of the section even if it injures others.”[1] “Second, only bad conduct involving deception comes within the scope of the section; fully disclosed misconduct cannot violate section 10(b).”[2][see footnotes]

Thel argues that this definition is not compelled by language of Act and that it is improper to frame the main purpose of the act as to encourage disclosure. He concludes that Section 10(b) was meant to be a much broader delegation of power to the SEC than the narrow definition the Court has gleaned from the Act. The author asserts that before the Court tackled the definition, the SEC was already narrowing its agenda and focusing on disclosure and antifraud provisions as regulatory goals (“Sunlight SEC”) instead of focusing on regulating trades on the market (“regulatory SEC”). Then 10b-5 was enacted and a lot of litigation over disclosure ensued before
the court considered the scope of 10(b). Author suggests that because the Court’s construction of 10(b) was so tied to the SEC’s rule and implementation of that rule, the court could change its construction of the statutory provision as new regulatory rules or agendas under existing rule 10b-5 emerge.
b. Microstructure Articles


This 2000 article seeks to empirically show that, contrary to other academic literature and the focus of regulations, “pure stabilization” does not occur in IPOs in the United States. Instead of stabilizing through “pure stabilization,” the author finds that price support activities are achieved through short covering, penalty bids, and the overallotment option. Each is a type of price support, “pure stabilization” and short covering simulate demand, while penalty bids work to restrict supply. (p. 1076). From the data collected, the author concludes that: “We find that pure stabilization, in which an identified stabilizing bid is posted, is never done, and that aftermarket short covering is the principal form of stabilization. As we discuss in detail, aftermarket short covering leads to the same results as "pure" stabilization but has no disclosure requirements. The short position must be taken ex ante, before trading starts, so we do find that sometimes short covering has to be done in the aftermarket even for IPOs that go up in price. Underwriters cannot predict completely which offerings will trade above or below the offer price. We also find that, on average, aftermarket short covering is not expensive for underwriters and amounts to a very small proportion of the gross spread they receive. Penalty bids are used selectively and tend to be assessed only for weak offerings. The underwriter can manage the price stabilization process by the combined use of covering the short position in the aftermarket, exercising the overallotment option, and restricting flipping by using penalty bids. The availability of these various options limits the losses incurred by the underwriter.” (p. 1077).

In discussing the regulatory history, the author states that “One of the key reasons given for stabilization was that underwriters do not have enough capital to do firm-commitment offerings and if they cannot perform these functions, then capital will not flow to industry.” (p. 1078). One reason given why pure stabilization is not used by issuers is because stabilizing bids are fluffed and that “would send a clear signal to the market that the offering is weak and stabilization is required.” (p. 1078) Additional evidence offered to show that these pure stabilization bids are not made is that “industry practice is to break up the syndicate before trading begins. The breaking up of the syndicate implies that the distribution is completed and if the syndicate has been broken up, according to SEC rules, stabilization bids cannot be posted.” (p. 1082). The reasons why it is more common for underwriters to use aftermarket short covering is discussed in the conclusion: “Aftermarket short covering achieves the same purpose as pure stabilization but is less risky and can be done without disclosure. Underwriters have to decide on the size of the short position ex ante. If a short position in excess of the overallotment maximum of 15 percent (naked short) is established, the commitment to short cover in the aftermarket is made even before the firm goes public. After the firm goes public, the underwriter still has the flexibility to decide how much of the short position to cover by exercising the overallotment option (up to a maximum of 15 percent).” (p. 1100). “The activity to which current regulations are addresses—pure stabilization—does not occur, probably in part because it is regulated.” (p. 1100).

The authors use data from 142 SEC enforcement actions (collected by searching press releases referencing Section 10(b) or 9(a) and the term “manipulation”) from 1990-2001 to analyze stock price manipulation (in the context of pump and dump schemes) and its implications for market efficiency. This data from SEC actions show “manipulators typically are informed parties such as insiders or brokers. Also, the effect of manipulation is increasing volatility, liquidity, and returns, especially when manipulators sell.

The article discusses empirical evidence from manipulation cases, including *WAMEX Holdings, Inc.* (p. 1933) and *Paravant Computer Systems, Inc.* (p. 1934).


(JSTOR, subscribers only – click [here](#))

The authors identify categories for manipulation: action-based manipulation (actions that change the actual or perceived value of the assets) and information-based manipulation (releasing false information or spreading false rumors). They offer a third category, “trade-based manipulation” (trader attempts to manipulate without utilizing strategies in other two categories and instead simply attempts to manipulate by buying and then selling. The author analyzes whether this is profitable under certain assumptions (rational expectations framework where agents maximize expected utility) and conclude such an uninformed manipulator can make a profit if the other investors assume he is an informed trader.


(available at upenn.edu– click [here](#))

In this short article, the authors ask the question: under what conditions is trade-based manipulation profitable? In contrast to other authors who have addresses this issue, the authors use the Glosten-Milgrom model and introduce asymmetry (where liquidity selling is more likely than liquidity buying) as a “more natural assumption.” Under this modification, where the degree of asymmetry is high, they show that profitable manipulation is possible.


(JSTOR, subscribers only – click [here](#))

This article is about action-based manipulation in the context of a takeover bids. The manipulator-bidder takes a large position in the target’s stock, imitating a serious bidder. This drives the price up, because investors think the takeover is really impending. Then the manipulator sells at the elevated price and drops the bid. It also shows how when there is little takeover activity, manipulations increase and this prevent some efficient takeovers, which harms shareholders and provokes them to want to ban manipulation. In contrast, when there is a lot of takeover activity and the potential for manipulation is higher, serious bidders benefit because they are able to take over at lower bids, thus making a higher profit and increasing their search for potential targets.

This article is about information-based manipulation/action-based manipulation, specifically insiders manipulating the market through “strategically distorted announcements or forecasts.” The article uses three kinds of insiders who make announcements that the public attaches credibility to and therefore who are capable of influencing price through public announcements: the journalist writing a financial column (as in the Winans case), the “guru” who writes newsletter forecasts, and the corporate executive with stock in his own company, all of whom are in the market. This is about both insider trading and manipulation: “…The insiders do not just trade in anticipation of future price movements, but also distort public information and prices. In addition to misleading announcements, this may take the form of withholding accurate information, or even require real resources to falsify evidence.” (p. 924) The article covers two types of manipulation (which can be undertaken by themselves or strategically combined). “Pre-announcement speculation,” which involves trading in anticipation of the announcement’s effect. Profit here depends on credibility of the announcer. “Post-announcement speculation” is making an announcement to “induce erroneous beliefs” and then trading on private information. The article gives examples of each. (p. 931).


The authors collected trading data from the Paris Bourse (in 1991) during the preopening period of the exchange, where preopening orders can be revised or cancelled prior to the opening. They use this data in order to study the process by which equilibrium prices are discovered and offer two hypotheses—the “noise hypothesis” and the “learning hypothesis.” The noise hypothesis suggests that because orders can be revised or cancelled during the preopening period, the trading might not be serious and informed and therefore the orders and prices do not contain information about the value of securities. Under the learning hypothesis, preopening prices are “conditional expectations, predicting unbiasedly the value of the security, with increasing precision.” (p. 1220). Similar to the racetrack betting market, the ability to change or cancel orders before the opening period raises the possibility of manipulation. The authors conclude that while there is some noise in the preopening prices, which might be the result of gaming or manipulation, preopening prices have informational content. The potential for manipulation does not prevent the market from reaching efficient pricing. “The relatively large degree of informational efficiency in the preopening indicative prices suggests that the discipline provided by the occurrence of immediate trades is not necessary for markets to reach informationally efficient outcomes.” (p. 1245)

Billington, Bruce, Morton, Richard, and Zhang, Tianming, “Managers’ Incentives to Avoid Meeting or Beating Earnings Expectations: The Role of Open Market Repurchases” (Available on SSRN – click here)

The authors hypothesize about the opportunistic behavior of management who avoid reporting earnings that meet or beat analyst expectations (MBE) in order to depress stock price prior to repurchases so repurchases occur at lower prices. They frame buying back underpriced securities as a wealth transfer to remaining shareholders from selling shareholders, which gives managers
direct benefits (because managers are remaining shareholders with large stake) and indirect benefits (because their future compensation and job security are aligned with remaining shareholders’ interests. Therefore managers have the incentive to repurchase at a lower cost and therefore report disappointing earnings, lowering the probability of MBE at the time of the repurchase. This hypothesis is proven empirically using OMR announcements from 1994 to 2006 using Security Data Company’s (SDC) Mergers and Acquisitions database, and accounting information from firms extracted from Compustat. (p. 4, 13), Because these tests rely on disappointing earnings released after the announcement of the OMR, the authors argue that this counters the argument that OMRs could be motivated by a period of low earnings.


This article concerns a trader with inside information but it discusses not only how that trader profits in a traditional insider trading sense, but also how the insider has an opportunity to manipulate the stock through trade-based manipulation. The author asserts that a trader with insider information can exploit this private information twice (once at the moment when he receives the signal and a second time, after the public announcement, because he can best infer the extent to which his information is reflected in the price already). Through a manipulative trading strategy, he speculates by building a position at the first moment, and then he trades aggressively when he receives his signal and tries to manipulate the price to maximize his informational advantage when the information becomes public. The author calls this “a novel form of trade-based manipulation,” and defines manipulative trading as “active trading with the intention of moving the price such that the informational advantage is enhanced at a later time.” (p. 3). How it works: “by trading more aggressively in the first trading round, the early-informed trader increases his expected future capital gains in later trading rounds. Put more bluntly, he generates a larger informational advantage by ‘throwing sand in the eyes’ of other traders.” (p. 3) This situation is in contrast to other situations because the insider/manipulator’s purpose is not to keep his position secret, but to “prevent others from inferring each others [sic] information from past prices while retaining one’s own ability to do so.” (p. 3). This is in contrast to Kyle (1985) because instead of trading less aggressively to save informational advantage for future trading, the insider/manipulator trades more aggressively to enhance future trading. (p. 3).

The regulatory impetus for this article was Reg FD and Rule 16(b) on short-swing profits. The author finds that insider trading reduces long-term informational efficiency and therefore supports Reg FD, which requires companies to make information available to make material information public simultaneously to all investors. (p. 4, p. 26).


The author looked at racetrack betting, a “naturally occurring asset market,” (p. 457) to ask whether markets can be manipulated and “what the effect of an attempted manipulation tell us about the way prices in centralized asset markets reflect the aggregated information held by traders.” (pp. 457-58). The conclusion is that the pari-mutuel racetrack betting market could not be manipulated. The abstract summarizes the study:
“To test whether naturally occurring markets can be strategically manipulated, $500 and $1,000 bets were made, then canceled, at horse racing tracks. The net effects of these costless temporary bets give clues about how market participants react to information large bets might contain. The bets moved odds on horses visibly (compared to matched-pair control horses with similar prebet odds) and had a slight tendency to draw money toward the horse that was temporarily bet, but the net effect was close to zero and statistically insignificant. The results suggest that some bettors inferred information from bets and others did not, and their reactions roughly canceled out.”

The author connects the study to larger manipulation questions about whether it is widespread: “The ability, or inability, to manipulate a naturally occurring market in a controlled experiment provides rare evidence of the feasibility of manipulation.” (p. 458) The author analogizes the temporary bets to large-block trades. (p. 459).

A definition of manipulation, for purposes of the article, is offered: “trading against one’s information or preferences, to create price movements that will lure other investors and ultimately allow later profit.” (p. 459).


This article deals with trade-based manipulation and the specific strategy of trading at a loss, undertaking short-term losses and increasing noise, and then making long-term profits. Using the Glosten-Milgrom bid-ask model, the authors show that “when the market faces uncertainty about the existence of an informed trader in the market, and when the number of periods of trading before all private information is revealed is sufficiently long, every equilibrium involves manipulation by the informed trader.”


The authors summarize current economic scholarship on manipulation and analyze it in terms of how a corporation can manipulate the market to the advantage of its shareholders and how a corporation can protect itself from having its shares manipulated by others. It analyzes both of these inquiries in terms of the Allen & Gale three-part framework of action-based, information-based, and trade-based manipulation. The article offers a helpful review of definition of manipulation, putting together: Easterbrook, Fischel & Ross, Anderson, Sundaresan, Newberry, Chichilnisky, and Jarrow. It ultimately adopts the Oxford English Dictionary definition “manipulate” is to “manage by dexterous contrivance or influence.”


This article looks at closing price manipulation by using an index the authors created of prosecuted manipulation cases in the United States and Canada. (Page 32 has a table
summarizing the manipulation cases in this context.) The authors created an index out of the data which measures the probability and intensity of closing price manipulation. They “find strong evidence of large increases in day-end returns, return reversals, trading activity and bid-ask spreads in the presence of manipulation.” (p. 3). They also offer the index as a way to study manipulation in areas where prosecution data is unavailable.

The focus of this article is on liquidity and the role of limit orders following IPOs. The proprietary data set covers 220 IPOs listed on the NYSE between January 1995 and September 1998. (p. 2340). The findings relating to stabilization conclude that order submission strategies by traders are influenced in part by expected underwriter stabilization. The authors assert that this data is unique because there have been very little analysis of IPOs on specialists markets such as the NYSE. (In a footnote, it is noted that: “IPOs in the United States have historically listed on either a regional exchange or the OTC market, and as a result, previous studies of IPO trading generally focus on the role of underwriters and market makers in the Nasdaq dealer market. However, IPO listings on the NYSE increased dramatically in the 1990s (see Corwin and Harris (2001)).” (footnote 2, p. 2340). Another difference between price support on the NYSE versus Nasdaq: “Specifically, underwriters typically stand willing to purchase shares during the initial days of trading in order to keep the stock price from falling below the offer price. Unlike on Nasdaq, where the lead underwriter typically becomes the predominant market maker (Ellis et al. (2000)), underwriters providing price support on the NYSE must submit trades to the specialist like any other trader.” (p. 2343).
The authors suggest that “order flow is more informative for hot IPOs than for cold, suggesting that underwriter stabilization limits the response of prices to limit book information.” (p. 2341).

This article discusses “monopoly and manipulation” in the futures markets. Starting from the premise that the futures markets come close to “perfect” textbook economies, the author finds it remarkable that there is so much regulation. The justification offered for this regulation is that the futures markets are subject to monopolization and manipulation by cornering the market or manipulating prices. The author acknowledges that these practices occur, but asks whether the threat of manipulation (seen as synonymous with “monopoly” in the futures market) is so serious as to justify restricting entry. He concludes it is not and that futures markets will take optimal precautions against manipulation such that the government has no advantage over private conduct as a regulatory force to combat manipulation.

Ellis, Katrina, Michaely, Roni, and O’Hara, Maureen, “When the Underwriter is the Market Maker: An Examination of Trading in the IPO Market,” The Journal of Finance, Vol. 55, No. 3 (June 2000), pp. 1039-74 (JSTOR, subscribers only – click here)
This article is mostly about trading by underwriters and market-makers during the three-month period following an IPO (on Nasdaq, firm commitment underwriting, specifically, see p. 1040 & 1048), but is consistent with the other microstructure articles which focus more on the overallotment option and not “pure stabilization.” The article seeks to fill a void in the academic literature by focusing on the post-IPO time period, when the underwriter becomes a market maker for newly traded stock. The data shows a connection between the underwriter’s trading profits and IPO underpricing: “This link suggests that IPO underpricing may be at least partially due to the integrated nature of the IPO process in that the underwriter directly benefits from underpricing the issue.” (p. 1042). In discussing the period after the newly offered stock begins to trade, it shows how the green shoe option can be used:

“But the IPO is far from being completed. Once the issue is brought to market, the underwriter has several additional activities to complete. These include the decision on whether to use the overallotment option, the after-market stabilization obligations, and the provision of analyst recommendations. The overallotment option (known as the "green shoe") grants an option to the underwriter to purchase from the company, within 30 days, an additional 15 percent of the shares sold in the IPO at the offer price. (The NASD sets the 15 percent limit for the green shoe option.) With this option, an underwriter can (and virtually always does) sell 115 percent of the firm's shares at the offering.6 The motivation for this option is to provide buying support for the shares without exposing the underwriter to excessive risk. If the offering is strong and the price goes up, the underwriter covers his short position by exercising the green shoe option at the offering price (and receives an additional gross margin of typically seven percent on the proceeds from the overallotted shares). If the offering is weak and the price goes down, the underwriter does not exercise the option, and instead buys back all or part of the extra 15 percent of shares in the market, thereby supporting the stock price. The overallotment option thus provides the underwriter with buying power in the aftermarket, enabling him to support the price of the newly traded security. The underwriter typically has 30 days to decide to exercise all or part of this option.” (pp. 1043-44)

This article raises the possibility of manipulation by “insiders” required to disclose their trades. The market cannot tell if the insider is trading on private information relating to fundamental value or for some other reason besides information about fundamental value. Therefore, uninformed insiders have an opportunity to profit. The authors argue that, while it is thought that disclosure rules “level the playing field” in the market, they can actually create an opportunity for insiders to profit without insider information. To move the price in a way that doesn’t reflect supply and demand is manipulation: “In effect, with disclosure, an uninformed insider can manipulate the market. The disclosure of one trade moves the price and creates a profitable subsequent trade. This is why an insider's expected trading profit can be higher with disclosure.” (p. 639).

This article examines how Regulation SHO affects manipulative (in the sense that it drives price below fundamental value) “naked” short selling that “masquerades as routine fails to deliver.” It compares two models of market equilibrium—one without a manipulator, and one with a manipulator. The article “shows how floating-price convertibles resolve the unraveling problem, so that even trade-based short sale manipulation is profitable.” Floating-price convertibles “allow the manipulator to resolve the unraveling problem by covering his short position with FPC conversion shares.”


This article discusses manipulation during a very specific context: secondary market trading prior to a seasoned offering (“SO”). The interaction between trading in the secondary market before the SO and the pricing of that offering create an opportunity for manipulation. An informed trader could sell short shares prior to the SO and profit later from the lower prices in the offering. This strategy gets around the inability-to-profit problem (due to “prices moving unfavorably each time they trade,” p. 214) because of the strategy of the manipulators taking advantage of the SO context: “To ensure success of the offering and compensate uninformed investors for the winner’s curse problem they face, new shares have to be issued at a discount from secondary market prices. A strategic trader possessing private information about the security value can influence the offer price by trading in the secondary market prior to bidding in the offering.” (p. 213). The effect of this manipulation on information and issuer pricing is: “Manipulative trading decreases the informativeness of the secondary market order flow, thereby exacerbating the winner’s curse problem faced by uninformed bidders and leading to an increase in the SO issue discount required to float the offering.” (p. 214).

The regulatory impetus for this article was NASD rule 10b-21, which prohibited traders from covering short positions established after a SO was announced with securities purchased in the offering. The article shows that “From a policy standpoint, we show that a ban on short selling prior to seasoned offerings may raise the issue discount and be costly to issuers. Even milder provisions such as the recently adopted NASD rule 10b-21, that increase the costs of manipulation, may in some cases have the unintended consequence of raising the costs of new issues.” (p. 215) A complete ban on short selling would prohibit information-motivated short selling, which economists agree is a good. (p. 234) Even rules like NASD 10b-21 can be costly to issuers because an increase in the number of manipulators from 1 to 2 makes secondary market trading more informative. (p. 235).


Although largely about comparing dividend strategies with repurchase strategies, this article tracks the growth in repurchases since the enactment of Rule 10b-18. For raw data, it offers that: “According to aggregate data from Compustat, expenditures on share repurchase programs (relative to total earnings) increased from 4.8 percent in 1980 to 41.8 percent in 2000 . . . while dividends only grew at an average rate of 6.8% [during the same time period]. (p. 1649). The
part of the article discussing Rule 10b-18 starts in Section VI, page 1676, which examines the effect of the enactment of 10b-18 on the market. It starts by describing the regulatory history of the regulation of repurchasing, and cites a Senate Committee Report from 1967, Senate Report No. 555, 90th Congress; 1967, which discusses when issuer repurchases are undertaken and their price effect. (p. 1677). It also includes a description of proposed rules 10b-10 and 13e-2. (10b-10 was proposed in 1967 and 13e-2 in 1970—both would have required repurchasing issuers to disclose repurchases and comply with time/price/volume/manner mandatory rules, see p. 1678).

(JSTOR, subscribers only – click here)
This article explores the profitability of speculation when the economy is in a stationary state. The article starts with the premise that many economists (unlike “noneconomists”) believe that speculators profit by making accurate predictions of future economic trends and that if they are successful in this, they will stabilize the economy. Then it takes away that effect and assumes prices are constant over time without this speculative activity. In this situation, the author suggests it is not clear whether speculators intervening in the market is profitable. Therefore, his paper identifies “conditions under which speculation is profitable, given that the economy is initially in a stable state.” (p. 590). The author develops a model that shows that there are a number of cases when manipulation is still profitable, including when non-speculative demand functions are nonlinear and satisfy a set of particular conditions.

(JSTOR, subscribers only – click here)
This article follows Fishman & Haggerty and Narayanan & John in discussing opportunities to manipulate by insiders required to disclose their trading. It concludes, however, that that the contrarian trading phenomenon is not “manipulation” b should be called “dissimulation” (“To maximize his expected profits, the insider dissembles his information by adding a random component to his trades.” p. 677). They argue that “dissimulation” provides a rationale for contrarian trading. This article engages in a long discussion of how an insider can maximize his informational advantage at every trading round, eventually showing “the optimality of adding a random noise component to informed trades, thereby diminishing the market maker’s ability to draw inferences from the public record.” (pp. 666-67). Put another way, “disclosure raises the prospect that market makers may deduce the insider’s private information. The insider thwarts this prospect by adding noise to his demands. We call this dissimulation. Dissimulation is costly since it causes the insider at times to trade in a manner inconsistent with his private information.” (p. 677)

(JSTOR, subscribers only – click here)
The authors of this short article offer an alternative explanation for the market reaction to open market share repurchases, that it is indicative of an “option value” because managers do not have to go through with the repurchase program:
“Past research has identified a number of factors that may explain the positive announcement returns observed after buyback announcements: personal tax savings, wealth transfers from bondholders, improvements in capital structure, and signaling. In this paper, we add another explanation to this extensive list. This alternative explicitly recognizes that open market repurchase programs are not firm commitments. This attribute distinguishes this mechanism from other buyback mechanisms such as fixed-price offers, where the same tax savings, signaling, and other arguments pertain as well. Open market programs authorize managers to use their firm-specific knowledge to the benefit of long-term shareholders by quietly reacquiring shares at some point in the future when, in management's opinion, market prices may have deviated from "true" value. This discretion is valuable. We model this as an exchange option whereby the market price per share is exchanged for the true value of the firm. To the extent that prices are always fair, such options will be worthless. Yet if market prices are not always fair, open market share repurchase programs may be valuable. In this paper, we show that this can occur even if prices are fair at the time of the announcement and management has no superior information.” (p. 21).

In a section on “Market Microstructure Issues,” the authors discuss other relevant microstructure scholarship and note that Barclay and Smith (1988) argue that repurchase programs increase bid-ask spreads and reduce liquidity. (p. 13). It generally criticizes microstructure articles, including Barclay and Smith, for not acknowledging the legal framework involved in repurchases.

*(available at www.cornell.edu– click here)*
In the vein of examining trade-based manipulation, the author looks at “market manipulation trading strategies” (defined as one that “generates positive real wealth with no risk”) by “large traders” (defined as “any investor whose trades change prices” who has no information) and examines under what conditions these strategies exist and do not exist. If the price depends on the past sequence of the trades by the large trader, then market manipulation is possible; otherwise, it is not. This analysis excludes market corners and short squeezes, which can always exist.

*(available at Econ Lit, subscribers only– click here)*
The main focus of this article is on the economics of the lead underwriters’ position when stabilizing. The authors take a step back from looking at stabilization and examine the “three types of aftermarket activity”: pure stabilization, syndicate short covering, and penalty bids. Each type is described in the introduction, but the focus of the article is on syndicate short covering. Short covering is not covered by SEC regulations, although if it is possible that it might occur, disclosure in the prospectus is required. (p. 621). Focusing in lead underwriters, the authors offer the main motives for conducting stabization (in addition to preventing or retarding a decline in price): favoring certain clients, protecting reputation and maximizing profits. (pp. 625-29).

(Available on SSRN – click here)

The idea behind this article is similar to the Mahoney article from 1999 (same stocks examined here as were examined in the 1999 article, but now more data)—that the data reveals manipulation was not the cause of the market problems of the 1920s. It uses a “hand collected new data set” to reach the conclusion that while the pools caused abnormal trading volume, it led only to modest average price increase in the short run, but not the long term, implying that there is no evidence showing the pools harmed small investors.

The article is more than just a historical re-examination—it ties in how this type of manipulation compares with modern contexts where successful manipulation is prevalent. In doing so, it provides a summary of the different types of contexts recent manipulation scholarship has focused on. The authors start by asking: “Can an uninformed trader profit from buying and then selling an asset?” (p. 2) and then reviews the current scholarship and models of profitable manipulation: “some financial economists have concluded that profitable “trade-based” manipulation is feasible. Allen and Gale (1992) and Aggarwal and Wu (2004) demonstrate the possibility of a pooling equilibrium in which the typical trader cannot distinguish informed investors and would-be manipulators, allowing the latter to influence prices strategically. Other models rely on investor irrationality or other departures from market efficiency. In Jarrow’s (1992) model, prices have momentum, enabling a manipulator to establish a price trend and then profit by trading against it. Mei, Wu and Zhou (2004) demonstrate that a trader can exploit investor biases by buying to drive up prices, then selling at a profit.” (p. 2) But then the authors ask if profitable trade-based manipulation is common and concludes: “Outside the limited context of penny stocks and other illiquid markets, the evidence of profitable trade-based manipulation is anecdotal.” (p. 2) The most famous example is the 1920s pools. The authors contrast this with the modern successful trade-based manipulation schemes: “The size, liquidity, and disclosure standards in that market, although modest by current standards, may have been sufficient to protect investors against manipulation. This contrasts with the relatively small and illiquid markets that account for the majority of manipulation cases brought by the SEC (Aggarwal and Wu, 2004). It also contrasts with futures markets, in which the supply of the underlying deliverable commodity or financial instrument can be cornered, causing severe price distortions (Merrick, Naik and Yadav, 2003). Our results suggest, then, that enforcement resources can be focused on discrete segments of the securities markets.” (p. 5) (emphasis added).

This has implications for the types of actions that we see the SEC has brought recently: “Currently, legal proceedings against manipulators arise principally in two circumstances. One involves futures markets in a commodity or financial instrument that can be cornered around the time of delivery, as described by Merrick, Naik and Yadav (2003). The other involves stocks traded in relatively inefficient markets such as the “pink sheets” in the United States or the stock markets of emerging-market countries (Aggarwal & Wu, 2004). It would be useful to understand how the risk of manipulation varies with the size and liquidity of the subject company.” (pp. 18-19)

Much of the article is devoted to the problem of not being able to distinguish manipulation from insider trading, concluding that “the evidence is more consistent with the hypothesis that
abnormal returns associated with the pools resulted from informed trading rather than successful trade-based manipulation.” (p.3) The authors discuss how insiders were pool participants. (p. 8). Also, since Maug (2002) concluded informed trading is more profitable for liquid stocks, might suggest insider trading, not manipulation, was the cause. (p. 10)

The article uses the data set to examine stock price and trading volume and concludes: “while the pattern of stock price and trading volume could be consistent with market manipulation, there is no evidence that the stock pools’ trades drove prices to artificially high levels. Therefore, we conclude that public investors were not harmed by pool operations.” (p. 5)

(JSTOR, subscribers only – click here)
This article extends Fishman & Hagerty’s article about the opportunity for manipulation by those insiders required to disclose their trading. It shows that this creates an incentive for insiders with information to trade against their information (“contrarian trading” or “trading in the wrong direction,” i.e. buying with bad news, selling with good news) to increase their trading profits by maintaining the informational advantage for a longer time. “This contrarian trading reduces the informativeness of her subsequent trade disclosure because the market is no longer sure whether an insider buy (sell) indicates good (bad) news. Consequently, the insider maintains her information superiority over the market for a longer period of time and uses it to reap large profits in later periods by trading in the ‘right’ direction. These profits more than make up for the losses suffered by trading in the wrong direction initially.” (p. 218). The consequences are that the market-maker sets smaller bid-ask spreads because losses to the insider are lower when she trades in the wrong direction and the market is less efficient because of the contrarian trades coupled with the disclosures.

(available at uva.nl – click here)
This discusses market manipulation in an emerging market, the Karachi Stock Exchange in Pakistan. The authors use trade data to perform an empirical study about manipulation by brokers trading for their own accounts. The brokers essentially arrange pools for pump-and-dump schemes and earn profits that are 4-8% higher annual rates of return than when the brokers trade as intermediaries for outside traders. It compares this phenomenon to the “pools” of the 1920s in the United States.

Kim, Jaemin; Schremper, Ralph; and Varaiya, Nikhil, “Survey on Open Market Repurchase Regulations: Cross-country examination of the ten largest stock markets,”
(available at sdsu.edu– click here)
This survey compares the repurchase regulations in the following equity markets (2000): United States, Japan, the United Kingdom, France, Germany, Canada, Italy, the Netherlands, Switzerland, and Hong Kong. The general conclusion is that most countries regulate open market repurchases (“OMRs”) strictly through disclosure and execution rules, and the US disclosure
requirements are the least stringent (this was before the 2003 amendment requiring disclosure.) The article goes through each country’s regulations and then compares them in terms of:

1. Whether board approval is sufficient to authorize repurchase or if approval at a shareholder meeting is required
2. Restrictions on timing, price, volume of OMRs
3. Disclosure requirements (in addition to standard disclosure in financial statements)
4. Whether there are trading restrictions/disclosure requirements on issuers when repurchase programs are underway

It discusses the relationship between the regulation of insider trading at the time of repurchase activity. (p. 12).


This article questions the ethics of companies announcing open market repurchases to take advantage of signaling effects without intending to follow through with the repurchasing. It calls for disclosure regulation of repurchases, which was not in existence at the time the article was written in 1997. It describes the purpose of open market repurchases from a corporate finance perspective and discusses how the repurchases work. It describes the safe harbor in Rule 10b-18 and finds it problematic that the conditions relate to the act of repurchasing the stock and not the announcement of open market repurchases. It offers the opinion that making a false announcement of a prospective repurchase could violate Rule 10b-5’s prohibition in making false statements or failing to state a material fact. (p. 1679). It criticizes the non-completion from an ethics standpoint, not a legal standpoint.


The authors argue that futures contracts (and, by extension, other derivatives) are susceptible to manipulation even where “cash settlement” (mandatory for “index” futures) is used in place of “physical delivery” to protect against “corners” or “squeezes.” This article is therefore in contrast to other articles about manipulation in the futures market which focus on physical delivery on the delivery date instead of cash settlement by payment from the “shorts” to the “longs” equaling the prevailing spot price less the futures price. Uninformed investors profit by taking a futures position and then trading in the “spot market” to manipulate the “spot price” used to compute the cash settlement at delivery. For example: “after establishing a ‘long’ futures position, the settlement price can be artificially bid up by buying up in the spot market. This is called ‘punching the settlement price.’ If the futures position is larger than the spot position, the net expected gain (i.e. profit on futures less loss on the spot) is positive.” (p. 1486). Market participants understand and adapt to this. As the number of manipulators grows, profits from manipulation decrease but welfare and price effects persist—“manipulation hurts futures noise traders, but benefits spot noise traders and informed traders through increased spot liquidity.” (p. 1496) The authors also discuss factors which might inhibit manipulation (transaction costs, position limits, risk aversion, etc.) and other contracts which are potentially susceptible to manipulation (physical delivery contracts, spot markets).

(JSTOR, subscribers only – click [here](#))

This is a general article about impounding information into price. The author describes a model showing how an insider makes profits by strategically using monopoly power to illustrate how “modeling price innovations as functions of quantities traded is not inconsistent with modelling [sic] price innovations as the consequence of new information.” (p. 1333).


(available at www.nyu.edu– click [here](#))

The authors suggest a definition for “illegal price manipulation.” They suggest we should not classify a trading strategy as “illegal price manipulation” unless “the violator’s intent is to pursue a scheme that undermines economic efficiency both by making prices less accurate as signals for efficient resource allocation and by making markets less liquid for risk transfer. Applying this, the following fit within the definition: corners and squeezes, pump-and-dump schemes. The definition does not include bluffing, randomizing, spreading true rumors, and punching the close. Authors believe their definition is consistent with both US case law and UK and EU codes of conduct.


(available at Cambridge Journals Online, subscribers only– click [here](#))

Comparing IPOs in the European Union and the United States, the authors examine stabilization regulations and practices (specifically, “pure stabilization” and ancillary stabilization, over-allotment/greenshoe option. The author discusses the theories explaining underpricing phenomena, and focuses on explaining it as a problem of asymmetric information. (p. 528). He asserts that “pure stabilization” does not occur in the US:

“It is crucial to note that the US empirical literature provides support for the hypothesis that only two of the three types of stabilisation are actually used. These are penalty bids and, in particular, syndicate short covering activities. In contrast and counterintuitively, there is no empirical evidence that stabilising bids (i.e., pure stabilisation) are used today in the United States in order to stabilise the share prices of IPOs. [footnote 47 here cites to Aggarwal (2000) article page 1082] This is an extremely important result, because pure stabilisation as a form of permitted market manipulation was and is thought to be the first and most important form of stabilisation and is indeed regulated very carefully by Rule 104, from both a material and a disclosure perspective, while short covering and penalty bids, which were and are thought to be residual devices, are substantially less regulated. (pp. 534-35).

The author concludes that “pure stabilization” does not occur in the United States because the potential cost can be so high. (p. 564).
(*available at hu-berlin.de – click here*)
This article was discussed in Mahoney (2004) and cited for the proposition that insider trading was more profitable in highly liquid stocks because it’s easier to hide. (see page 1583 and p. 1588 of Maug). This was described in Mahoney as contrasting with the current manipulation schemes which tend to take place in illiquid stocks and also cited for support that what was going on in the pools of the 1920s was closer to insider trading than manipulation as we think of it today.

McNally, William, Smith, Brian, and Barnes, Thomas, “The Price Impacts of open Market Repurchase Trades”
(*Available on SSRN – click here*)
Looking at the Toronto Stock exchange repurchase trades from 1987 to 2000, the authors study the average intraday price impact of repurchase trades versus non-repurchase trades. After measuring the price impact of repurchase transactions, it looks at two explanatory hypotheses about the price impact: the “competing market-maker hypothesis,” which “attributes the price impact directly to the actions of the repurchasing company,” and the “timing/identification hypothesis,” which “attributes the price impact to the response of the market to the company’s buying activity.” (p. 5). The main conclusion is that there is “strong evidence that companies exhibit timing ability when they repurchase but that the market does not respond to mandatory disclosure if it significantly lags the repurchase trades.” (p.1). Using the Toronto Stock Exchange (TSX) allowed the researchers to examine the effect of the repurchases over the course of 13 years because their legal rules required disclosure of open market repurchases (OMRs) before the U.S. did with its amendments to Item 703 of Reg S-K, etc. Rules are similar in Canada (see page 4 and pages 7-8—Canada rules treat repurchasing companies as insiders and require disclosure within one month of the trade) although the regulation of OMRs is framed as a prohibition, not a safe harbor. In discussing the “competing market maker hypothesis,” the authors acknowledge the work of Barclay and Smith (1988) and Cook, Kligman, and Leach (2004), which discuss how repurchasing companies compete with market-makers by providing liquidity through bids (submitting limit orders) which keeps the bid less likely to decrease and how companies instruct institutional brokers to repurchase when stock price falls below a certain point. (p. 5). The analysis of the “timing/identification hypothesis” discusses how repurchase trades are identified on the TSX because in Canada, the issuers are legally required to announce the repurchase, the issuers are prohibited from buying on the upticks and are required to use only one broker—so following these patterns repurchase trades can be identified. (p. 6). The conclusion that prices do not react to publication of repurchase trades suggests, according to the authors, that the time between the trade and disclosure obligation should be shortened so that outside traders can use this information. (p. 18)

(*available at ScienceDirect, subscribers only – click here*)
The author suggests that although the purported reason for the Exchange Act was to regulate stock pools which were seen as engaging in manipulative activity, the evidence produced during the Senate’s investigation of the pools does not support the conclusion that the pools were
“manipulating” the markets. The author states that there has not been enough analysis about whether the pools were in fact successful manipulations and examines daily and monthly return data on stocks that were the subject of pools. He found that, on average, positive abnormal returns were made when the pools were formed, but the returns do not reverse over the course of the next six months, suggesting that the pools were trading on the basis of inside information (at a time when Congress was not concerned with insider trading), and these were not successful “manipulations.” Finding no “manipulation” to justify the Exchange Act, the author suggests that the Act was passed because Congress wanted to have more political control over the NYSE. The author also asserts that our current characterization of the 1920s pools as manipulative reveals a misunderstanding about the difference between modern traders and traders in the 1920s. Procedures for large trading in the secondary market and underwriting were not fully developed, and therefore the pools allowed brokerage houses to distribute securities and also facilitated informed trading. The Senate committee members, he concludes, did not appreciate that when the dealers traded for their own accounts, they were increasing liquidity without making prices volatile. Congress wanted to eliminate the pools because they did not like brokers trading as principals instead of as agents for customers.


This article looks at a “pump and dump” scheme and offers empirical evidence from the SEC prosecutions in this area. The article shows how a manipulator can profit in this context by taking a large position in the target security while pushing the price up and then selling at high prices. This paper starts from the premise that, unlike the rational expectations paradigm, behavioral studies that suggest investors are not fully rational and therefore it is more worthwhile to explain how investors can profit from the irrational behavior of other investors. The model assumes three actors: a behavior-driven investor (who is reluctant to sell “losers,” the “disposition effect”), an arbitrageur (preventing market crashes and large jumps within his limits, “the limits of arbitrage”), and a manipulator who is “a large investor who is a price setter rather than a price taker. As a deep-pocket investor, he pumps up the stock price with a series of buying orders and then dumps the stock to make a profit by taking advantage of the disposition effect and the limit of arbitrage.” (p.2) The authors explain how this adds “something new” to the existing literature: “A distinctive feature of our model is its explicit investigation of how smart money (the manipulator) interacts with irrational traders and makes profit by exploiting their behavioral biases. In other words, the manipulator in our model manipulates the price process to create more chances for the irrational investors to make mistakes. This is an important feature, but largely assumed away in the existing behavioral finance literature.” (p. 3) The authors distinguish their model from the Allen & Gale (1992) model because their model “does not impose assumptions on information asymmetry of the probability of manipulation.” (p. 8). The authors offer why this type of manipulation should be recognized by regulators: “Conventional wisdom suggests that smart money’s speculation tends to make the market efficient by offsetting the foolishness of some investors. This paper provides a new counterexample. Smart money may actually create “market inefficiency”, by driving asset prices away from their fundamental value, rather than forcing asset prices to converge to their fundamental values. This possibility poses a new challenge for regulators. As the manipulator relies on neither inside information nor visible actions (other than trading), his manipulation is difficult to be detected and ruled out.” (p. 35).
(Available on SSRN – click here)
This article is very technical and talks about developing a method for detecting cases of market abuse using the Italian Securities and Exchange Commission (CONSOB). While it is one of the only articles that used probability theory and quantitative analysis to develop a “market abuse detection” procedure, it is hard to contextualize it with other scholarship or discern how much of these conclusion rest on the Italian exchange data used and would not be transferrable to US securities markets.

(Available on SSRN – click here)
This SSRN article purports to be “the first to investigate both the price distortions as well as trading positions of major market participants during the six-month period of a well-publicized market manipulation episode – the attempted delivery squeeze in March 1998 long-term UK government bond futures contract traded on the London International Financial Futures and Options Exchange (LIFFE).” (p. 4). This article uses a very comprehensive data set to make its empirical conclusions, particularly about “how learning takes place.” It tracks how “dealers and customers who are squeezers” and “contrarians” use trading strategies to make a profit (or do not profit) in these contexts.

(HeinOnline, subscribers only – click here)
This counters Easterbrook, Fischel, Ross, Edwards & Edwards, et al. who say that government regulation of futures markets is not necessary in light of the self-regulation that is already in place in the markets. The author attacks the underlying theoretical arguments of the “self-regulation is enough” camp, arguing that the arguments are inconsistent with the actual behavior of exchange members. Also, he asserts that the authors taking that position ignore the costs of manipulation on consumers of exchange services or those who rely on the futures markets for information—and since those exchange members don’t bear these costs, they do not have the same incentives to self-regulate to eradicate them.

To bolster his argument, the author examines ten different exchanges (with particular focus on the Chicago Board of Trade) in the pre-regulatory period and concludes that the exchange members adopted very few measures to combat manipulation. The author concludes that the use of government sanctions against manipulation would be more efficient than leaving the exchanges to self-regulate.

(Available on SSRN – click here)
This article discusses the EU’s Market Abuse Directive. At the time the article was written, there were no European cases under the directive, and so the author discusses some hypothetical applications of the directive. Part of the directive is aimed at manipulation. The article breaks
down how regulation of manipulation works in this regime: “The Market Abuse Directive states that “Member States shall prohibit any person from engaging in market manipulation.” Manipulation is defined in a complicated way: “first, in the Market Abuse Directive itself; secondly, in two of the second level directives; and thirdly in guidance by CESR.” (p. 15). It also includes a table which breaks down how this framework applies to particular manipulative conduct, which it breaks down into four “variants” including: false or misleading transactions, price positioning, transactions involving deception, and false or misleading information. (p. 16) It offers a similar definition for trade-based manipulation that is used in the US: “More complications can arise for market manipulations by “false or misleading transaction” (first variant) and by “transactions involving deception” (third variant). They are defined as “transactions or orders to trade which give, or a likely to give, false or misleading signals as to the supply of, demand for or price of financial instuments” [sic] and “transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance”. (pp. 16-17). It notes that it can be difficult to distinguish between these two variants. (p. 17). The article offers several manipulation hypotheticals and discusses how the directive would apply. (pp.17-21). It also discusses the “accepted market practices” (“AMPs”) which are “negative criteria” (safe harbors) but notes that these are not uniform throughout the EU: “These AMPs are not uniform in the EU but depend on the particular market. EU law only provides a list of factors which should be taken into account when considering market practices, and CESR has drafted a format for assessing AMPs and publishes the AMPs of Member States on its webpage. This lack of complete uniformity arises for a number of reasons including the fact that AMPs depend on the liquidity and depth of the relevant market.” (p.21).

(JSTOR, subscribers only – click here)
This article discusses a manipulation scheme with the opportunity for a manipulator to trade twice and profit. The abstract describes the model:

“A Kyle (1985) model with private information diffusion is used to examine the motivation to spread stock tips. An informed investor with limited investment capacity spreads imprecise rumors to an audience of followers. Followers trade on the advice and move the price. Due to the imprecision of the rumor, the price overshoots with positive probability. This gives the rumormonger the opportunity to trade twice: First when she receives information, then when she knows the price to be overshooting. In equilibrium, rumors are informative and both rumormongers and followers increase their profits at the expense of uninformed liquidity traders.”

The authors suggest the rumormongers are small investors trying to manipulate their information-based profits. (p. 1499). Here is how the manipulator benefits from inside information twice: “The paper's analysis uses a special case of a Crawford and Sobel (1982) signaling game in which an informed trader occasionally receives private information about a security's true value. Upon receiving the information, she trades in a Kyle (1985) auction that represents a short period of trading activity. Because her trade is swamped by the total trading volume, her price impact is negligible so that she has information left after trading. To enhance her profits, the informed trader spreads vague yet informative rumors to followers who, through
their collective trading, move the price. By spreading a binary (either a bullish or a bearish) rumor whenever she knows a security's future value, the rumormonger can steer the price to one of two rumor prices. Because the liquidation value follows a continuous distribution, the rumor drives the market price beyond the true value with positive probability. This potential overshooting gives the rumormonger the opportunity to benefit from her information twice: First she trades in the direction of her information, then she trades in the opposite direction when she knows the rumor to be overshooting. In the presented model, the rumormonger increases her expected profits from being informed by more than 50 percent.” (p. 1500).

(available at ScienceDirect– click [here](#))
In this short article, the author uses game theory to explain two types of market manipulation: (1) takeovers and stock market trading and (2) agents spreading false rumors about a company or committing a criminal act against a company while the manipulator shorts or buys put options that benefit when the market price declines. The author generally advocates the use of game theory models to complement rational expectations models.
8. Books & Treatises

**JOHN C. COFFEE, JR. & HILLARY A. SALE, SECURITIES REGULATION: CASES AND MATERIALS** (11th Ed. 2009)

**JAMES D. COX, ROBERT W. HILLMAN, & DONALD LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS** (5th Ed. 2006)

**LARRY HARRIS, TRADING & EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS** (OXFORD 2003)

**THOMAS LEE HAZEN, SECURITIES REGULATION: CASES AND MATERIALS**, (7th Ed. 2006)


**LOUIS LOSS AND JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION** (5th Ed. 2005)