

9-1-1997

The Concept of Securities Manipulation and Its Foundations in France and the USA

Hubert de Vauplane

Odile Simart

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/bjil>

Recommended Citation

Hubert d. Vauplane & Odile Simart, *The Concept of Securities Manipulation and Its Foundations in France and the USA*, 23 Brook. J. Int'l L. 203 (1997).

Available at: <https://brooklynworks.brooklaw.edu/bjil/vol23/iss1/10>

This Article is brought to you for free and open access by the Law Journals at BrooklynWorks. It has been accepted for inclusion in Brooklyn Journal of International Law by an authorized editor of BrooklynWorks.

ARTICLES

THE CONCEPT OF SECURITIES MANIPULATION AND ITS FOUNDATIONS IN FRANCE AND THE USA[†]

*Hubert de Vauplane** &
*Odile Simart***

ABSTRACT

Except in the United States, the crackdown on securities manipulation remains the “black sheep” of the penal financial law. This article analyzes the differences between the American and French concepts of securities manipulation and the divergent doctrines they have spawned. In light of the enactment of the July 2, 1996 law [in France] which established and modified the penal nature of the infraction, the article inquires into the appropriateness of maintaining a dual penal and administrative penalty.

In the last couple of years, penal financial law was principally concerned with insider trading, and starting with the United States, most industrialized countries have put in place

† This article is a translation from the original French by Latif Oduola-Owoo, J.D. candidate, Brooklyn Law School. The article first appeared as *La notion de manipulation de cours et ses fondements en France et aux USA*, REVUE DE DROIT BANCAIRE ET DE LA BOURSE, No. 56, July-Aug. 1996, at 158. The publisher, Editions du Juris-Classeur, has granted the *Brooklyn Journal of International Law* permission to reprint this translated version of the article. Where possible, an attempt has been made to conform citations to *The Bluebook*; however, much of the French citation format has been preserved.

* Paribas Bank, Associate Master of Conferences, Pantheon-Assas University (Paris II).

** Magistrate of Business Jurists, Paris II. The authors thank Ms. Ducouloux-Favard (Paris IX) and Professor James A. Fanto (Brooklyn Law School) for their invaluable collaboration in writing this article, and especially for providing access to American doctrine and jurisprudence.

some form of legislation on the subject¹ on account of the principle of "reputation."²

Today, a fair repression of insider trading is assured through satisfactory rules of law, and regulatory authorities have shifted their focus to other practices such as securities manipulation, particularly the boiler³ variant. While there is legislation and a copious jurisprudence to penalize insider trading, it must be noted that, except in the United States, the crackdown on securities manipulation remains the "black sheep" of the penal financial law. The numerous financial scandals in the United States in the late 1980s gave rise to an abundant anti-manipulation jurisprudence that was widely discussed.⁴ More generally, the crash of 1987 gave rise to a two-pronged inquiry into certain practices in the market: on the one hand, were these practices partly at the origin of the disaster, or did they at least contribute to the heavy fall in the market, and on the other hand, could some of these practices be considered manipulative?

The purpose of this article is to analyze the principles that govern the infraction of securities manipulation within the American and French systems (manipulations of commodities will not be examined in this study).⁵ There is not enough room in this presentation to study certain financial practices that would fall under the scope of this legislation were they not protected by some legal exemption; such is the case with the

1. For an analysis of the various legislation, see E. GAILLARD, *INSIDER TRADING: THE LAWS OF EUROPE, THE UNITED STATES AND JAPAN* (Kluwer Law & Taxation Publishers, Deventer, 1993).

2. Hubert de Vauplane, *Protection de l'épargne et concurrence de places*, *BANQUE ET DROIT*, No. 41, May-June 1995, at 37.

3. Cf. Working Group Report of the XVIII Conference of OICV, *Bull. COB*, 1993, No. 275.

4. Consider the examples of Michael Milken, Drexel Burnham Lambert, Ivan Boesky, Dennis Levine, Boyd Jefferies, GAF Corporation, Salim "Sandy" Lewis, Paul Bilzerian, etc. For a global perspective on these different types of manipulation, see A.F. Mathews et al., *Manipulative Practices: Past, Present and Future*, in *TRADING PRACTICES, THE PORTFOLIO EXECUTION PROCESS, AND SOFT DOLLAR PRACTICES 1990* (Practicing Law Institute ed., 1990).

5. Commodities manipulation will not be discussed even though the French penal infraction originally targeted commodities and not securities. For a more detailed study of the manipulation of securities in commercial markets, see Jerry W. Markham, *Manipulation of Commodity Future Prices: The Unprosecutable Crime*, 8 *YALE J. ON REG.* 281 (1991), which, in light of the professionals' failure to stop all manipulative practices, calls for a reinforcement of the Commodity Futures Trading Commission's powers.

stabilization of a stock after it has just been offered in the market.

Although the objectives sought are identical in both countries, it soon becomes apparent that the foundations of this repression are not the same on both sides of the Atlantic. In France, until the last reform effected by Law No. 96-597 of July 2, 1996 with respect to the modernization of financial activities, the foundation of the penal infraction was essentially moral, where in the United States, only a violation of the principles of market economy constitutes the foundation of the offense. One should also note a great difference in the effectiveness of the legislation in combating these practices, the American regulation being better adapted than its French counterpart. Although the relative size of either of these stock markets partly explains this observation, it remains more fundamentally true that among the constituent elements of the infraction in France, there existed a strong moral component that posed a hindrance to prosecution. On the other hand, American legislators tend to multiply infractions, thereby weakening the importance of the intent element. Finally, absent an integration of the financial theory of fraud-on-the-market, French magistrates, unlike their American counterparts, face great difficulties in characterizing the damages. All these elements no doubt explain the fewer number of cases in France as opposed to abundant jurisprudence on the subject in America.

In France, the reform of financial infractions under the above-cited law falls within a trend that seeks to minimize the moral component of the infractions.⁶ However, the New Penal Code tends to exclude objective or material infractions. While one may have no option other than to subscribe to this perspective with respect to securities manipulation, one must be reticent to do so with respect to insider trading. In fact, an examination of the respective foundations of insider trading and securities manipulation leads to the conclusion that the latter is an intrinsic economic infraction, while the former is

6. The modifications in the phrasing of these infractions seek to incriminate behavior rather than persons. The most important changes achieved by this reform are the exclusion, with respect to insider infractions, of communication of privileged information, dissemination of false information, and reference to the "market."

more moral in nature. This observation is coupled with an inquiry into the effectiveness of the French regulation: Would it not have been preferable, on account of a better effectiveness of norms, to decriminalize securities manipulation and allow the Commission des Operations de Bourse (COB) exclusive competence on the subject?

We will first study the history and foundations of the infraction (Part I) before attempting to give a definition of the concept of securities manipulation (Part II). Such an approach will permit an examination of the constituent elements of the infraction (Part III). Finally, it would be appropriate to inquire into the effectiveness of the rule (Part IV).

I. HISTORY AND FOUNDATIONS OF THE INFRACTION

While the prohibition of stock manipulation is older in France than it is in the United States (Section A), it appears from the outset that the foundations of the prohibition are divergent on both sides of the Atlantic (Section B).

A. *An Infraction that is Older in France than it is in the United States*

If Americans were the first to reprimand insider practices, it was the English⁷ and the French who first addressed the harmful influences of manipulation of commodities and financial stock markets.

1. A Genesis of the Infraction

It is well known that the first securities manipulation case was adjudicated in England in 1814 in the matter of *Rex v. de Berenger*.⁸ Subsequent to a rumor about Napoleon's death, stock values in London rose astronomically, and later collapsed when the rumor turned out to be unfounded. Berenger and some friends seized the occasion to sell all their holdings and thus realized substantial profits. The court condemned this practice, holding that the public had a right to a natural and

7. For a comparative study of securities manipulation in Great Britain and the United States, see How Chih Lee, *Market Manipulation in the US and UK*, COMPANY LAW., vol. 14, No. 5, May 1993, at 84 and No. 7, July 1993, at 123.

8. *Rex v. de Berenger*, 3 Maule & S. 67, 70, 105 Eng. Rep. 536, 537 (K.B. 1814).

free market, and that it was not necessary to show a detriment to the state or a profit realized by the defendants. In 1892, English jurisprudence indicated that no distinction could be made between manipulation resulting from divulging false information and manipulation carried out by means of false and fictitious acts.⁹ These two decisions established the free-and-open-public market doctrine.

In France, the history of securities manipulation is linked to that of speculation. From the Revolution to our times, the notion of speculation, and the distinction between its licit and illicit forms, have undergone a slow evolution. The old law,¹⁰ or even the intermediate law, often tended to confuse it with *agiotage*,¹¹ which Mirabeau defined as "the use of the least delicate maneuvers to produce unexpected variations in prices of public stocks to profit from the misfortune of those one has deceived."¹² The drafters of the Penal Code of 1810 did not have a precise idea of the issue, and were only concerned with combating collusion and acquisitions.¹³ In their original drafts, articles 419 to 422 of the Penal Code targeted *agiotage*. But while these articles penalized the infraction of price alteration or collusion—sometimes also called illicit actions on the market, or illicit speculation—these texts were not applicable to stock market transactions, even though the initial project anticipated them.¹⁴ Thus, article 419 penalized only hikes or drops in commodities, merchandise, or public titles, but was

9. *Scott v. Brown, Doering, McNab & Co.*, [1892] 2 Q.B. 724, 730 (C.A.), cited in LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* ch. 10, at 3946 (3d ed. 1992).

10. For a historical study since antiquity, see Martin, *La Spéculation Illicite*, Dijon Thesis 1922, at 13 et seq.

11. For a study of *agiotage* and acquisition, see TCHERNOFF, *TRAITÉ DE DROIT PÉNAL FINANCIER* (1931); L. Mazeaud, *Le délit d'altération des prix*, REC. D. IV 145 (1927); more recently, see E. Thivieau, *L'agiotage sous Necker et Calonne* and *L'agiotage sous la révolution*, in *LES MARCHÉS FINANCIERS FRANÇAIS: UNE PERSPECTIVE HISTORIQUE* (Association d'économie financière, 1994).

12. Diderot defined *agiotage* as "the commerce of one who, for whatever profit, converts bills, promises, or contracts into money, who deals in stocks, who accords such values to all commercial instruments with the hope of deriving some profit." *ENCYCLOPÉDIE OU DICTIONNAIRE RAISONNÉ DES SCIENCES, DES ARTS ET DES MÉTIERS* 636 T. I (1777).

13. Plachte, *La Spéculation illicite sur le marché financier*, Thesis, Paris 1933, at 3.

14. For an analysis of the provisions of article 419, see C. Ducouloux-Favard, *DROIT PÉNAL DES AFFAIRES* 129 (Masson, 1st ed. 1987).

not applicable to securities, a fact which the *Cassation* Court confirmed in 1885.¹⁵ It was not until the Law of December 3, 1926 that private stocks were added to the list of items targeted by article 419, and the constituent elements of the infraction were somehow modified (namely, a mere attempt became punishable). The Order on Prices of December 1, 1986 inadvertently abrogated article 419-2. However, Law No. 88-70 of January 22, 1988 concerning stock values corrected this legislative procedural error; securities manipulation became a specific stock law infraction under article 10-3 of Order No. 67-833 of September 28, 1967.

Thus, in France, securities manipulation is an old concept inherited from illicit speculation, which later evolved to specifically adapt to the stock market. Since Law No. 89-531 of August 2, 1989, securities manipulation may also be penalized as a violation of rule No. 90-04 of the COB. This duality of repressive authorities gives rise to a duality of qualification: correctional infraction and/or COB violation, even though they each have different constituent elements. Moreover, this does not mean that a substantial manipulation constitutes an infraction while a less serious manipulation constitutes a COB violation.¹⁶ Finally, as we will soon see, the last reform effected by Law No. 96-597 of July 2, 1996 has modified the intent element of article 10-3.

2. A Late Beginning in the United States

Although more recent, the American legislation on the subject of manipulation has some older roots that are traceable to the influence of English jurisprudence. In fact the United States has also adopted the free-and-open market theory, but this did not take place until the 1920s. At common law, every form of manipulation was deemed fraudulent: simultaneous purchases and sales, false information, and "corner."¹⁷ The two major financial statutes were enacted in 1933 (Securities Act) and 1934 (Securities Exchange Act) subsequent to the financial crash of 1929. The first one deals in general with the

15. *Chambre criminelle* [Cass. crim.] June 30, 1885, D.P. 1886.1.389.

16. *But see* Y. GUYON, *ASPECTS JURIDIQUES DE LA MANIPULATION DE COURS: RAPPORT MORAL SUR L'ARGENT DANS LE MONDE* 87 (P.A.U. ed., 1995).

17. A corner is the purchase of a stock at a higher price in order to compel term sellers to execute their stocks at the buyer's price.

issuance of securities while the second one sets the judicial framework for the operations of registered and unregistered secondary markets. Of the two, the 1934 legislation is the more important: It has numerous provisions to combat various forms of manipulation, and, more important, it seeks to achieve full disclosure in the market through the elimination of manipulation. Since Congress empowered the SEC to regulate this type of practice (article 10(b)), a number of SEC regulations are based on this legislation (rules 10b-1 to 10b-21).

B. A Different Philosophy Linked to Speculation in Each Country

In the United States, the 1934 Act was a response to the anxiety of a public convinced that stock market activities deeply affected the economic well-being of the country. There was a general consensus that speculative activities in the market and the attendant manipulations contributed significantly to the crash of 1929 and the Great Depression.¹⁸ A legislation that would reduce speculation without necessarily destroying the market was required. Manipulation, a fraudulent form of speculation,¹⁹ became the focal point of the problem, and the essential justification for the evocation of federal intervention. The intent of the legislation was to protect the investor against deceptive practices that artificially affected the market and impaired the normal interplay of supply and demand.²⁰

In France, it would seem at first glance that the legislation adopted a similar approach: a desire for transparency and integrity of the market, and a desire to control the harmful

18. It is interesting to note that the 1934 legislation expressly states in section 2(4) that the purpose of the federal legislation was that:

National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets

Securities Exchange Act § 2(4), 15 U.S.C. § 78b(2)(4) (1994). For more on the motivations for the 1933 and 1934 legislation, see A.A. Berle, Jr., *Stock Market Manipulation*, 38 COLUM. L. REV. 393 (1938).

19. Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 394 (1990).

20. William R. McClucas & Alma M. Angotti, *Market Manipulation*, 22 REV. SEC. & COMMODITIES REG. 103 (1989).

effects of speculation—was the infraction not rooted in illicit speculation? In fact, it goes beyond that. The law in France particularly seeks to moralize the market. Illicit activities not only injure the interests of investors, they also allow unjustified profits at the expense of all participants.²¹ The moral aspect was, therefore, strongly emphasized in the legal definition of this infraction. Nevertheless, the new definition of the infraction modifies the import of the intent element.

The American approach is more economic in nature: the infraction was created in reaction to an economic crisis, and with the view to obtain a true interaction of supply and demand. On the other hand, the French approach is more moralistic: to prevent others from obtaining unjustified gains and to restore balance and equity in the distribution of profits. This great difference probably accounts for the near absence of French jurisprudence on the subject. To our knowledge, there are only two judicial decisions on the subject, one about a merger²² and the other on the so called "boiler" practice,²³ whereas across the Atlantic, there are numerous decisions. Is it not easier to prove economic facts than it is to prove a moral intent?

1. Securities Manipulation and Its Impact on the Social and Moral Order

The links between law and morality have never been as divergent in the past as they are today. This observation is particularly pertinent to speculation.

a. Manipulation-Speculation Links

The notion of manipulation is fundamentally linked to that of speculation. It invokes a form of illicit speculation. What then is an illicit speculation? How do we distinguish it from a licit one? Our understanding of speculation is radically differ-

21. Ch. Freyria, *Les aspects répressifs de la réglementation boursière actuelle*, REVUE DE DROIT BANCAIRE ET DE LA BOURSE, No. 8, July-Aug. 1988, at 113.

22. Tribunaux de grande instance [T.G.I.] Paris, Mar. 5, 1993, RJDA 10/93 No. 813; BANQUE ET DROIT No. 31, Sept.-Oct. 1993, at 23 note Peltier.

23. T.G.I. Paris, Mar. 14, 1990, Gazette du Palais [Gaz. Pal.] June 21, 1990, at 335 note J.P. Marchi; RTDCOM. 1990, at 662; Bulletin Joly [Bull. Joly] 1990, at 777, sec. 231. On appeal, Paris, Feb. 19, 1991, Droit pénal, July 1991 No. 202 note J.H. Robert.

ent on either side of the Atlantic.

In France, and until recently, speculation had always received bad press. Thaller defined it broadly as "the idea of enrichment or lucre directed toward values which one influences."²⁴ Although it is still occasionally perceived as facilitating "easy money," our attachment to capitalism, a market economy, and competition has triumphed over the negative connotation it stills evokes.²⁵ Our attitude remains, nonetheless, ambiguous; speculation sometimes arises in the context of "a financial maneuver for a productive investment, and at other times, in the context of dishonest activities to obtain illegitimate gains."²⁶ This ambiguity is even reflected in our judicial system; it is either a threat to economic stability, or a catalyst of the market. Thus, the concept of manipulation does little more than add to the confusion. In fact, manipulation appears as an abuse of the speculative phenomenon; an abuse manifested through disloyal and dishonest maneuvers.²⁷

In the United States, on the other hand, manipulation seems more independent of speculation. The latter is considered a normal practice. Although federal financial law denounced the harmful consequences of speculation as the catalyst of the crash of 1929, the legislation seeks primarily to regulate all practices that tend to disrupt the market and the free interplay of supply and demand.²⁸

Certainly, on either side of the Atlantic, practices that tend to incorporate active (*dolosives*) maneuvers cannot be likened to speculation.

24. Thaller & Percerou, *Traité de droit commercial*, 7th ed., No. 14.

25. Ripert, *Aspects juridiques du capitalisme moderne*, LDGJ 1951, at 163 et seq.

26. D. Ponton-Grillet, *La spéculation en droit privé*, D. 1990, ch. 157.

27. This distinction between manipulation and speculation is emphasized in the Paris Court of Appeal decision of June 28, 1984 (Gaz. Pal. Oct. 23, 1984, at 649): "To qualify an intervention on the stock market as normal or abnormal is beyond any objective criteria once the sales and purchases took place at applicable rates. Speculation, or even random speculation, is not in itself an infraction, except in the specific instance of securities manipulation."

28. Thel, *supra* note 19, at 393.

b. Penalizing Immoral or Illegal Conduct

The media coverage received by some manipulation cases, especially in the United States, has uncovered the inequality between seasoned investors who are knowledgeable of investment techniques (both legal and illegal ones) and the average investors. As is the case with insider trading, the attitudes are ambiguous: everyone dislikes manipulation, but everyone would like to benefit from it. Society in general is also shocked at the impunity with which the manipulator acts. In fact, the speculator knows that his activity is likely to alter the regular functioning of the market. But he does not know if his intervention will be enough to bring about a hike or a drop. In other words, he runs a risk in light of the indeterminate nature of his intervention. His profit is thus a result of the risk taken. On the other hand, the manipulator, just like the inside trader, eliminates the element of risk since he creates his own financial environment. His profit therefore seems abnormal, resulting neither from financial analysis nor from the free interplay of supply and demand (the manipulator himself artificially modified the supply or demand of the stock).

Nevertheless, one would be hard pressed to perceive stock manipulation as essentially immoral conduct; in other words, as conduct contrary to the goodness of the end, the means, and the circumstances. The imposition of a penalty for this practice appears more, to use an expression dear to Durkeim, as the expression of society's indignation. Rather than aiming at morality, the repression of securities manipulation appears more like a simple economic effectiveness measure.

c. Penalizing Conduct Contrary to the Integrity of the Market

The consolidation of markets has accentuated competition between financial markets, and the transparency and integrity of a market are factors that determine its competitiveness. Securities manipulation affects the transparency of a market²⁹ and therefore equal access to information. The imbalance of information and the artificial creation of supply or demand, which are both principal characteristics of securities manipulation, thus constitute a prejudice to the principle of equality.³⁰

29. de Vauplane, *supra* note 2, at 37.

30. *Pour une éthique des marchés financiers*, BANQUE No. 502, Feb. 1990, at

But beyond equality between investors and respect for supply and demand, securities manipulation more importantly affects confidence. Confidence is a state of mind that determines the conduct of buyers and sellers. Financiers observe it keenly, attempt to stabilize it, or even to reinstate it when it disappears.³¹ This confidence, which is ensured through transparency, can only be sustained if investors have faith in the institutions and the rules. If participants lose confidence in the market, they are disinclined to invest in it; the market is then discredited, and it loses all attraction. Americans speak of a policy of full disclosure and truth telling. All bad faith and dishonest practices must therefore disappear from the market in order to make its agents more dependable.³²

2. Securities Manipulation and Its Effects on the Free Interplay of Supply and Demand

In addition to its effects on a market's integrity, securities manipulation is first and foremost conduct that is contrary to a market economy. This becomes manifest from the permeation of the American financial jurisprudence with economic and financial theory.³³ In fact, one of the most important judicial applications of economic research undoubtedly derives from the theory of market efficiency which postulates that real prices of active stocks must correspond to their theoretical values.³⁴ This theory underlies the fraud-on-the-market theory.

a. Effects on Market Efficiency and the Fraud-on-the-Market Theory

For economists, the primary purpose of a financial market is to provide signposts that permit the distribution of resources among different participants in the market. It is therefore

130.

31. J. Birouste, *Anthropologie de la confiance*, in *RAPPORT MORAL SUR L'ARGENT DANS LE MONDE* (1994).

32. J.M. Servet, *Histoire d'un mot*, in *RAPPORT MORAL SUR L'ARGENT DANS LE MONDE* (1994).

33. Mark L. Mitchell & Jeffrey M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 *BUS. LAW.* 545 (1994).

34. Rainier J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 *VA. L. REV.* 549 (1984).

important that stock capitalization provides at all times the best possible evaluation of a company's worth. To this end, the market must integrate information with respect to assets and transform it into a price which ultimately will determine the equilibrium between supply and demand. Speculation thus plays a preponderant role, since it facilitates this equilibrium by allowing for a better circulation of information among participants, and, in the process, helping to stabilize the market.³⁵ In that sense, speculation contributes to market efficiency.

Since the time of Eugene Fama, it is also known that the market efficiency theory considers prices of active stocks to be perfectly reflective of all available information. These prices thus undergo a "random walk."³⁶ This means that whatever information is likely to affect a stock is completely and instantaneously reflected in the stock, and the current price of the stock represents the expectation of future prices subject to the information and its being identically available to all agents. At all times in this efficient market, available information is reflected in the price of the active stock, and this in turn always provides a good estimate of its intrinsic value.

The difficulty resides then in the determination of this intrinsic value. Fama indicated that in an efficient market, the combined actions of all operators cause the real price to fluctuate in an indeterminate way about its intrinsic value. Consequently, the more the number of informed agents, the greater efficient the market will be, and the more likely it is to evolve along the lines of an ideal market where prices of active stocks undergo a random walk. In this model, information is essential to the theoretical construct. That is why it is also referred to as informational efficiency. It may take on three forms: weak, semi-strong, and strong.³⁷ This theory of efficiency thus opens up new ways of articulating financial theory around information. Moreover, it demonstrates the key role information plays in the functioning of stock markets.

35. J.F. Rouge, *La spéculation: règles du jeu*, PA 6 Aug. 1993, No. 94, at 16; Hubert de Vauplane & J.P. Bornet, *Droit de la Bourse*, LITEC, at 178.

36. Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

37. Hubert de Vauplane & C. Denoun, *Les justifications de la lutte pénale contre les opérations d'initiés*, PA 28 No. 37, Mar. 1994, at 4.

It is now conceivable how securities manipulation adversely affects market efficiency. In fact, according to Pareto's optimality theory,³⁸ every agent supposedly ameliorates the global state of the economy by having access to perfect information. In a manipulated environment, however, information is not perfect because it is distorted (artificially created by one or more manipulators). This market inefficiency is also reinforced by the imbalance of information (equality of information is nonexistent since some investors, namely the manipulators, have access to information unknown to others). In other words, the information on which the other investors supposedly rely has been truncated by the manipulators. Where there is imbalance of information, it is possible that some "ill-informed" agents will anticipate based on subjective, psychological criteria rather than objective, albeit unobservable, market criteria. Such a situation leads everyone to imitate everyone else. It may also induce operators to behave irrationally, thereby causing speculative bubbles that may give rise to financial crises.³⁹ Consequently, manipulation may be likened to short-term speculation, and a short term speculative market is inefficient.⁴⁰

Thus, strictly from an economic perspective, securities manipulation affects market efficiency. However, this is not necessarily so for insider trading.

In the United States, this economic theory has been transposed into the judiciary through the fraud-on-the-market theory. Traditionally, the plaintiff alleging fraud had to show that he had studied the misleading financial reports and that he substantially relied on them for his decision. But since most investors do not study financial reports, they had their cases dismissed. The courts' attitude began to change in the mid-1970s when the effects on market efficiency were invoked.⁴¹

38. Vilfredo Frederico Pareto (1848-1923). Pareto's optimum refers to the optimum common to producers and consumers, which in a competitive environment will not improve the condition of one of them without detriment to another.

39. J. Bouvier, *La déficience des marchés efficients*, BANQUE, No. 497, Sept. 1989, at 827. For a deeper coverage of financial euphoria and market irrationality, see CH.P. KINDLEBERGER, *HISTOIRE MONDIALE DE LA SPÉCULATION FINANCIÈRE DE 1700 À NOS JOURS* (P.A.U. ed., 1995).

40. Kenneth A. Froot et al., *Herd on the street: Informational Efficiencies in a Market with Short-term Speculation*, 47 J. FIN. 1461 (1992).

41. Baruch Lev & Meiring de Villiers, *Stock Price Crashes and 10b-5 Damag-*

Thus, in the matters of *Affiliated Ute Citizens v. United States* and *Mills v. Electric Auto-tite Co.*, the court recognized the existence of a presumption of reliance when there is non disclosure or omission of a material fact.⁴² Federal courts broadened this presumption to apply to misrepresentation and also declared that the presumption was rebuttable.

In the matter of *Chris-Craft Industries v. Piper Aircraft Corp.*, the Second Circuit adopted the fraud-on-the-market theory, where the investor may depend on the integrity of the market when he buys or sells stocks. The court also admitted that the theory may be applicable where the fraudulent conduct was not directly attributable to the seller. In *Blackie v. Barrack*, the Ninth Circuit held that this presumption could be overcome by showing that the investor based his decision primarily on some source other than the integrity of the market. Although the primary reliance test was not applied in *Panzerer v. Wolf*, the fraud-on-the-market theory was retained in the 1988 Supreme Court decision of *Basic v. Levinson*.⁴³

The fraud-on-the-market theory derives from the market efficiency theory, since it relies on the principle that the investor may rely on the market price of a stock as reflective of its true value. Consequently, any deceptive statement that alters the price is fraudulent, even if the average investor was not aware of it. However, the adoption of this theory by the courts has sometimes been criticized by American doctrine. First, some have deplored the fact that it was not supported by copyright law with respect to a company's information. Some writers have argued that the fraud-on-the-market theory should apply only if the defendant, especially the director of the issuing company, owes the plaintiff a fiduciary duty to disclose.⁴⁴ In our opinion, this criticism is justified only when the information is private, or when it applies to insider trading. But as far as manipulation is concerned, this fiduciary duty does not exist, since the manipulator is not necessarily the seller.

Moreover, several studies have shown that the Supreme

es: *A Legal, Economic, and Policy Analysis*, 47 STAN. L. REV. 7 (1994).

42. Joseph De Simone, *Should Fraud on the Market Theory Extend to the Context of Newly Issued Securities?*, 61 FORDHAM L. REV. S151 (1993).

43. See *id.*; Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of The Fraud-On-The Market Theory*, 42 STAN. L. REV. 1059 (1990).

44. Macey & Miller, *supra* note 43, at 1059.

Court adopted the semi-strong version of efficiency.⁴⁵ Consequently, it is appropriate to limit the application of this theory to semi-strong markets. Furthermore, since this semi-strong efficiency needs to be proved, everything will depend on the adopted test. Another difficulty, as pointed out by some writers, lies in the fact that the price of a stock is not necessarily uniformly efficient (some information may be more costly), and the market is not necessarily uniformly efficient with respect to a given stock.⁴⁶ It is thus proper to limit the application of this theory to efficient markets; it should not apply for example, to cases involving manipulation of newly issued stocks.

b. Effects on Stock Formation

We have already seen that the principal characteristic of financial markets is their ability to integrate information directly and transform it into price. This operates to homogenize different parameters, thus providing the "fairest" value of the stock. Moreover, this price determines the equilibrium between the supply and the demand of a stock. Thus, speculation has a stabilizing effect on the market. But securities manipulation disrupts this equilibrium. In fact, the constituent element of the infraction of securities manipulation, both in the United States and in France, is the modification of a stock by disrupting the normal functioning of the market. Thus, price fixing is no longer pertinent since the price is already falsified. Moreover, manipulation disrupts the equilibrium between supply and demand since it creates its own demand by misleading others through an artificially created supply. In reality, the manipulator sends out false signals and compels other investors to react based on information that will eventually prove false. The information imbalance thus gives rise to speculation over a price that is inefficient. Manipulation is thus synonymous with destabilizing speculation. As a matter of fact, it is for this reason that legislators tend to regulate stock stabilization practices strictly in order to prevent artificial prices.⁴⁷

45. De Simone, *supra* note 42, at S151; Macey & Miller, *supra* note 43, at 1059.

46. Macey & Miller, *supra* note 43, at 1059.

47. See, namely, J. Thibaud & S. Duroux, *La stabilisation de cours en période d'émission*, MTF, 1992, No. 46, at 50.

Not only does speculation affect the aptness of a market, it also disrupts its liquidity. In fact, it would seem that absent a balance of information, term contracts and derivatives are more susceptible to manipulation than the underlying active stocks.⁴⁸

In France, without the integration of the financial theory of fraud-on-the-market, courts have difficulty characterizing the adverse impact on the natural interplay of supply and demand. Thus, even though the decision was rendered under the old article 419-2 of the Penal Code, the Paris Court of Appeal in a June 28, 1984 decision held that to characterize an intervention on the market as normal or abnormal is beyond any objective criteria once the transactions were carried out at the applicable rates. Consequently, a massive intervention on the market is not intrinsically suspicious.⁴⁹

The condemnation of manipulation is thus apparently based on objective criteria rather than moral ones. In that light, the penal repression seems excessive. Only a decriminalization (for the adoption of an administrative repression) would reconcile the condemnation with the foundations that justify it.

II. A TENTATIVE DEFINITION OF SECURITIES MANIPULATION

Being a purely economic infraction, the concept of securities manipulation is distinct from similar concepts like fraud or speculation (Section A). It is interesting to note that unlike in the United States, the French legislation proposes a generic definition of the concept of manipulation (Section B).

A. *An Original Concept*

Every financial regulation seeks to facilitate the proper working of the market, and to this end, it prevents and proscribes manipulation.⁵⁰ But what is manipulation? Is there just one definition of manipulation, or is it different according

48. Praveen Kumar & Duane J. Seppi, *Futures Manipulation with "Cash Settlement,"* 47 J. FIN. 1485 (1992).

49. Paris, June 28, 1984, Gaz. Pal. 1984.1.649, note J.P. Marchi.

50. American jurisprudence consistently emphasizes this goal. See, e.g., *United States v. Charnay*, 537 F.2d 341, 347 (9th Cir. 1976); *United States v. Stein*, 456 F.2d 844, 850 (2d Cir. 1972).

to markets? How do we differentiate securities manipulation from the infraction of manipulation? In other words, does every manipulation constitute an infraction?

In either American or French law, some uncertainty surrounds the legal definition of manipulation. This confusion arises from the fact that other infractions are closely similar to manipulation.

1. Manipulation and Fraud

It is well known that the concept of manipulation is not the same at common law as it is under French law. Intent is not necessarily required. It suffices, for example, that a statement be made. There is no regard to whether the statement is true or false for it to be considered fraudulent. Due to this fact, the distinction between manipulation and fraud in American law is not always clear. This led to the suggestion that manipulation is nothing but another type of fraud.⁵¹

In French law, under the principle of legality, fraud is not punishable unless some law specifically proscribes the conduct.

2. Manipulation and Illicit Speculation

In France, the infraction of securities manipulation was inherited from the older infraction of price alteration under article 419 of the Penal Code.

Article 419-2 targeted individual or collective actions on the market aimed at achieving abnormal profit. The old text required a special "*dol*": the action on the market had to have as a goal the realization of some gain that would not normally result from the free interplay of supply and demand. Article 419-1 of the Penal Code, abrogated on March 1, 1994 at the enactment of the New Penal Code, targeted the use of fraudulent means. As a matter of fact, this article was coincidentally similar to securities manipulation. However, the material element of the infraction was rather extensive: the condemned result consisted in artificially effectuating hikes or drops in commodities, merchandise, or public and private stocks. Although the article specifically proscribes certain practices (bids

51. Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 HARV. L. REV. 503, 507 (1991).

made to disrupt stock prices, oversupply, fallacious or calumnious allegations deliberately sowed in the public, etc.), it also refers to "any fraudulent way and means." The infraction thus proscribes all fraudulent conduct that falsified the free interplay of supply and demand. Culpable intent was therefore an essential element of the infraction. It was often difficult to appraise this conduct since judges had to make a distinction between good and bad speculation. This explains the near absence of jurisprudence on the subject. The same thing applies to securities manipulation: the legislators apparently did not learn any lesson from the experience of article 419. In fact, the material element of article 10-3 is redundant of that of article 419: fallacious and calumnious allegations sowed in the public are not different from statements or maneuvers that tend to induce others into error. Until the reform effected by the law of July 2, 1996, the only difference between both positions consisted in the fact that manipulation was an infraction of commission, while illicit speculation was additionally an omission infraction. One must therefore be pleased at the abrogation of article 419, which was manifestly serving the same purpose as the infraction of securities manipulation.⁵²

3. Manipulation and the Infraction of Dissemination of False Information

The infraction of dissemination of false or misleading information is defined in article 10-1 sub. 3 of the 1967 Order. The material element consists of the dissemination to the public of false or misleading information by any way or means whatsoever. The result is immaterial: the conduct remains punishable even if the goal sought is not realized. It is sufficient that the information be such as would affect the market.⁵³ Although intent to affect the market is not required, it is nonetheless necessary to prove that the dissemination of infor-

52. Freyria, *supra* note 21, at 114.

53. See *In re Société Générale de Fronderie*, which involved both an insider infraction and a false information infraction. T.G.I. Paris, ch. 11, Dec. 20, 1990, Gaz. Pal. 1991.2.461, note J.P. Marchi; on appeal, Paris, Jan. 15, 1992, Gaz. Pal. 1992.1.293, note J.P. Marchi; in *Cassation*, Cass. crim., Mar. 15, 1993, D. 1993, at 610 note C. Ducouloux-Favard; and on remand, Orleans, June 20, 1994, D. 1995, at 81 note C. Ducouloux-Favard; Cass. crim., Oct. 19, 1995, Rev. soc., 1996, at 323 note B. Bouloc.

mation is voluntary.⁵⁴ Thus, it is important to distinguish this material element from the material element in article 10-3; in both instances there is a desire to disrupt the proper functioning of the market in order to influence stock variations. However, unlike securities manipulation, dissemination of false information does not entail a direct intervention on the market. One writer appropriately described it as "manipulation of minds."⁵⁵ The dissemination of false information is generally linked to insider transactions and securities manipulation. Would it not be more appropriate to incorporate this infraction with articles 10-1 and 10-3 of the 1967 Order as is the case in American law?

If it is not easy to differentiate between stock manipulation and other similar concepts, it is even more difficult to give it a unitary definition.

B. A Concept Defined Only in France

While French legislators have precisely regulated securities manipulation, the United States has adopted a more global approach. In fact, across the Atlantic, there is no securities manipulation infraction. Instead, they have a regulation for manipulative financial practices.⁵⁶ This constitutes an essential difference between both legislations since in the United States, unlike in France, there is no legal definition.

1. The American Legislation

There are numerous enactments directed at manipulation, but we will only name the following:⁵⁷

54. de Vauplane & Bornet, *supra* note 35, at 279.

55. S. Alamowitch, *De la rumeur à la manipulation: la diffusion de fausses information*, MTF No. 74, Oct. 1995, at 13.

56. Thel, *supra* note 19, at 385.

57. In addition to the four cited provisions, there are other anti-manipulation provisions in the following texts: sections 5(a) and 17(a) of the Securities Exchange Act of 1933, sections 15(b)(4)(E) and 17(a) of the Exchange Act of 1934. For a global perspective of this regulation, see JOSEPH I. GOLDSTEIN, AN OVERVIEW OF MARKET MANIPULATION: LEGAL AND PRACTICAL ASPECTS (PLI Securities Enforcement Institute, 1990).

a. Section 17(a) of the 1933 Securities Act

This provision generally proscribes fraud and the dissemination of inaccurate or inadequate information attending the sale of securities.⁵⁸ It covers both registered and unregistered stocks. But it penalizes only fraudulent conduct on the part of the seller. Though this article is not the most important in combating manipulation, it lends precision to the notion: manipulation is broadened to encompass the dissemination of false information.

b. Section 9 of the 1934 Exchange Act

Section 9(a)(1) to 9(a)(5) proscribe a series of practices that have been declared manipulative by a congressional study prior to the enactment of the Exchange Act. Application of these sections are limited to securities registered on the national financial markets (NYSE and AMEX).⁵⁹ However, cases have tended to extend its application to over-the-counter transactions as well.⁶⁰ Article 9(a)(1) proscribes the operation of washed⁶¹ sales or matched orders.⁶² But these practices do not constitute a violation unless they are committed with the intent to create a false or misleading appearance of activity with respect to a stock on the market. Article 9(a)(3), (4) and (5) particularly proscribe certain practices where broker-dealers and other persons sell, offer for sale, buy, or offer to buy registered securities.⁶³ Article 9(a)(3) forbids these people from inducing the sale or purchase of securities by spreading information likely to give rise to hikes or drops in the values of these securities subsequent to some manipulation, while article 9(a)(4) forbids anyone else from engaging in the same activities for a consideration. Article 9(a)(4) also forbids these people from inducing the purchase or sale of a stock by making false or misleading statements. These provisions seek to eliminate

58. *Aaron v. SEC*, 446 U.S. 680, 695-700 (1980).

59. *McLucas & Angotti*, *supra* note 20, at 103.

60. *In re Barrett & Co.*, 9 S.E.C. 319, 328 (1941); see Martin A. Rogoff, *Legal Regulation of Over-The-Counter Market Manipulation: Critique and Proposal*, 28 ME. L. REV. 149 (1976).

61. *In re J.A. Latimer & Co.*, 38 S.E.C. 790, 792 (1958).

62. *In re Thornton & Co.*, 28 S.E.C. 208, 209-10 (1948).

63. *Chemetron Corp. v. Business Funds Inc.*, 682 F.2d 1149, 1164 (5th Cir. 1982).

tipster sheets practices or touting (an aggressive promotion of a stock using a spokesperson who has a financial interest in the goal sought).

As one may observe, the spectrum of proscribed manipulative activities is very broad. Nevertheless, they all have a common characteristic: they operate to distort the market and artificially alter prices by appealing to the speculative impulses of other investors. A more subtle form of manipulation consists of using actual trading to give the impression of a bona-fide trading activity. This practice involves either a conscious price hike to create the impression of a rising demand for a given stock at increasing prices, or a conscious drop in prices to create the impression that more investors are selling as prices drop. Article 9(a)(2) seeks to penalize this type of manipulation, and more generally, every strategy used to convince the public that the activity on a stock reflects authentic demand.⁶⁴ The key element, as we will later see, is the intent, since without intent, manipulation could not be proved.

Finally, articles 9(b)-(d) allow the SEC to regulate everything that relates to the acquisition, endorsement, or guarantees of "puts," "calls," or other options.

Section 9 of the Exchange Act thus clearly distinguishes between good and bad manipulation. In other words, it distinguishes between legitimate and illegitimate activities, intention being the criterion of distinction.

c. Section 10(b) of the 1934 Exchange Act

Section 10(b) is by far the best known and the most important anti-manipulation provision.⁶⁵ It proscribes the use of manipulative or misleading means or strategies with respect to the purchase or sale of securities. Unlike article 9, article 10(b) and subsequent rules apply to all stocks (with a few exceptions) in financial or over-the-counter (e.g., NASDAQ) markets. Moreover, the provision itself adapts to all forms of manipulation since the SEC is vested with the power to regulate all

64. *Ray v. Lehman Bros. Kuhn Loeb Inc.*, 624 F. Supp. 16 (N.D. Ga. 1984); *SEC v. Resch-Cassin & Co.*, 362 F. Supp. 964, 975 (S.D.N.Y. 1973).

65. Norman S. Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. MIAMI L. REV. 671 (1986).

"new means of manipulation or deception."⁶⁶ Article 10(b) delegates discretionary powers to the Commission, which uses these powers to codify transactions that are more likely to be subject to manipulation, namely transactions made during the selling period (Rules 10b-2 to 10b-21). Under this provision, it is illegal for anyone, directly or indirectly:

- to use any means, strategies or tricks to defraud;
- to give any erroneous statement of a material fact, or to omit a material fact thus rendering the statements made misleading in light of the prevailing circumstances;
- to engage in any act, practice, or professional activity, that is fraudulent or misleading to anyone connected with the sale or purchase of securities.

The essential elements are thus, deception, inaccurate statements, or omissions that lead to an imbalance in the information, which underlies the interplay of supply and demand.

d. Section 15(c) of the Exchange Act

In addition to the above-named articles, section 15(c) regulates broker-dealer activities by forbidding them to engage in any manipulation or stabilization.⁶⁷ Transactions which, without any reason, induce the client to intervene on the market are proscribed. So is scalping (where a broker-dealer buys titles before recommending them to his client with the goal of reselling them when prices rise) and parking (a practice where a stockholder fails to disclose his owner status and sells stocks with the complicity of an intermediary with a promise to rebuy them).

Finally, the SEC promulgated a regulation with the view toward exercising better control over broker-dealer activities on penny stocks (stocks transacted over-the-counter at a rate that is less than one dollar per action)⁶⁸ and "pink sheets" (a stock other than NASDAQ transacted over-the-counter and featured

66. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976).

67. *Clearly v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983).

68. 17 C.F.R. § 240.15c2-6 (1996); see Anthony De Toro, *Market Manipulation of Penny Stocks*, 17 SEC. REG. L.J. 241 (1989); Joseph I. Goldstein & L. Delane Cox, *Penny Stock Markups and Markdowns*, 85 NW. U. L. REV. 676 (1991).

on a list published daily by the National Quotation Bureau).⁶⁹

2. The French Legislation

The French legislation has only two enactments: article 10-(3) of the 1967 Order, and the COB Regulation 90-04.

It is important to note that before the 1996 reform, the essential element of the infraction was intention. The material element consisted of a maneuver that featured two apparently cumulative conditions: to disrupt the normal functioning of the market, and to deceive investors.

The penal enactment was subjective. However, a COB violation was originally objective since no intention was required. Neither manipulation nor maneuver is an issue in a COB violation: in fact, the text enunciates the principle of free interplay of supply and demand in stock markets (article 2). It then refers to impediments to the issuance of stocks and the inducement of others into error. Through this perspective, which is more economic than moral, it penalizes nefarious conduct rather than bad action. It is not concerned with bad faith. Rather, its focus is on the undesirable end-result of the action and its consequences.⁷⁰ In this respect, it is closer to the spirit of the American legislation. Finally, deontological rules require the financial intermediary to respect the transparency and security of the market by refraining from all manipulation (with respect to the market or his clients).⁷¹

3. Definition of Manipulation in Both Countries

In France, punishable manipulation consists of a maneuver exercised on the market with a view to impair its proper functioning by inducing others into error. Consequently, mar-

69. 17 C.F.R. § 240.15c2-11 (1996).

70. See *Graslin/COB*, Bull. COB No. 288, Feb. 1995, at 21, where the Commission penalized a stock manager for using a negotiation record for discontinued bids as a "purchase/sold" slip for the purpose of eliciting quotations at pre-determined prices thereby preventing the stocks in question from being subject to the free confrontation of purchases and sales. *Chron. financière et boursière*, BANQUE ET DROIT, No. 42, July-Aug. 1995, at 29 chron. F. Peltier.

71. F. Périer, *Abrégé de déontologie des activités financières*, REVUE DE DROIT BANCAIRE ET DE LA BOURSE, No. 18, Mar.-Apr. 1990, at 58; F. Périer, *La déontologie des activités financières*; RAPPORT MORAL SUR L'ARGENT DANS LE MONDE (Association d'économie financière, P.A.U. eds., 1994).

ket disruption results from the investors' mistakes, which are brought about by the manipulators. The term "maneuver," which replaced the word "action" in article 419 of the Penal Code, covers bids or machinations made with the goal of causing artificial hikes or drops in stock values.⁷² This change in terminology allows for a better distinction of non-reprehensible practices by underscoring the organized nature of the operation that underlies the infraction.⁷³ This term "maneuver," although less neutral than "action," still allows for different interpretations. It suggests either some dealings to mislead, a practice closer to the "*dol*," or some external material act done to support and inspire confidence into some false statement, a practice closer to fraud. Until the Law of July 2, 1996, it was a commission infraction which required proof of an intent to alter prices. This then raises some questions about the importance of leaving out the term "knowingly" from article 10-3.

In the United States, a definition of manipulation can only be inferred from the cases and a study of the doctrine. The Supreme Court held that manipulation generally referred to "practices like simultaneous sales, matched orders, price hikes or drops with a view to mislead investors by artificially induced market activity."⁷⁴ In other words, manipulation presumes an intent to deceive investors by artificially controlling stock prices.⁷⁵ Thus, every artificial interference that alters the free functioning of the market constitutes manipulation.⁷⁶ This process is thus the reverse of what obtains in France: the goal is not to disrupt the market by inducing others into error, but to defraud another by affecting the market. The result is nevertheless the same: defrauded investors and a disrupted market. This definition sets two limits: first, it distinguishes manipulation from other practices proscribed by section 9(a); and second, deception seems to be an essential element.⁷⁷ A Su-

72. Rapport Auberger, *Doc. Ass. Nat.*, 1987-1988, No. 1159, at 113.

73. J. Saint Geours, *La COB face à la manipulation de cours*, RAPPORT MORAL SUR L'ARGENT DANS LE MONDE (P.A.U. ed., 1995).

74. *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977).

75. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976).

76. *Pin v. Texaco*, 793 F.2d 1448, 1451 (9th Cir. 1986); *Kadiman v. Ladish Co.*, 792 F.2d 614, 627 (7th Cir. 1986); *Ray v. Lehman Bros. Kuhn Loeb Inc.*, 624 F. Supp. 301, 304 (S.D.N.Y. 1983); *Trane Co. v. O'Connor Sec.*, 561 F. Supp. 301, 304 (S.D.N.Y. 1983), cited in De Toro, *supra* note 68, at n.43.

77. Poser, *supra* note 65, at 671.

preme Court decision confirmed this by holding that there cannot be manipulation without misrepresentation, i.e., inaccurate statements or nondisclosure of material facts.⁷⁸ The doctrine itself proposes other definitions.⁷⁹ For some, manipulation is conduct aimed at either inducing others to transact in a stock, or to force the price of a variable stock to an artificial level.⁸⁰ Others define it as a deliberate interference with the free interplay of supply and demand in the stock market. Finally, some others who find all these definitions unsatisfactory wonder: when can it be said that prices are not real but artificial? What is an interference? How do we define an inducement to transact in a stock? Is it not possible to encourage an investor to intervene in the market without necessarily seeking to defraud? In fact, in an interesting article, two economics professors try to demonstrate the inadequacy of the above-cited definitions.⁸¹ The first criterion must be rejected. Otherwise every act that induces investors to act will qualify as manipulation, and it would be enough that the investor be induced to act without a specific goal. The second criterion cannot be retained either, since it is impossible to distinguish a normal price from an artificial one. Finally, the third criterion is also useless since interference is not definite and presupposes a distinction between a legitimate and an illegitimate demand. Under these circumstances, the only acceptable definition is one whose foundation lies in the manipulator's bad intent.

III. THE CONSTITUENT ELEMENTS OF THE INFRACTION OF STOCK MANIPULATION

It is not enough to define manipulation; one also needs to know the constituent elements of the infraction since manipulation per se is not punishable.

78. *Schreiber v. Burlington N. Inc.*, 472 U.S. 1 (1985), cited in Poser, *supra* note 65, at 671.

79. The concept of manipulation was studied in depth by Judge F.H. Easterbrook, in *Monopoly, Manipulation and the Regulation of Futures Markets*, 59 J. BUS. S. 103 (1986).

80. Thel, *supra* note 19, at 393.

81. Fischel & Ross, *supra* note 51, at 507.

A. The Market

Though strictly speaking a market is not a constituent element, it is at least a condition precedent. In both countries, the scope of anti-manipulation legislation is voluntarily broad. Article 10-3 of the 1967 Order, just like the COB regulation, refers to the market, a scope that is broader than the stock market. As is the case with insider trading, it is proper to inquire into the impact of this enactment on over-the-counter transactions. The COB and the courts have extended the provisions for insider violations to OTC markets.⁸² As surprising as it may seem, it is very likely under the circumstances that the same solution applies to securities manipulation. In an unregulated market, stocks are not subject to rules that limit their variation; consequently it is hard to determine whether a variation is normal or results from manipulation. However, there is the possibility that the omission, in the Law of July 2, 1996, of any reference to "the market" with respect to insider trading, considerably broadens the possibility of incrimination. This omission may lead to the assumption that the infraction exists independently of the market where it took place.⁸³ Some doubt, therefore, may be entertained as to the import of this legislation. The new financial law having clearly distinguished between regulated markets and over-the-counter markets, would it not have been preferable to maintain the reference to "the market," which in fact could have covered both types of markets? One must inquire then into the meaning of the word market, since it was left out of the insider infraction, but retained in the definition of securities manipulation.

In the United States, sections 9 and 10 of the Exchange Act apply to both official and over-the-counter markets. And like in France, this regulation covers everyone who intervenes on the market.

82. Paris, Nov. 15, 1994, Bull. Joly bourse 1995, § 2, at 9 note Hubert de Vauplane. As to unregistered markets, article 1 of rule 90-04 expressly extends its reach to its operations.

83. *Compte rendu analytique* officiel, No. 66, jeudi Mar. 14, 1996, at 190, intervention Jolibois.

B. Paramount Importance of the Intent Element

On either side of the Atlantic, the existence of a material element is necessary to characterize manipulation.

In France, under article 10-3 of the 1967 Order, the material element consists of a maneuver exerted on the market for the purpose of impairing its regular functioning by inducing others into error. A single lie therefore should not be enough to characterize the infraction. This is so in order to distinguish it from fraud. Nevertheless, the distinction remains unclear since according to the COB, an action on the market is characterized as fraudulent.⁸⁴ Moreover, the maneuver must be exercised on the market. In other words, it is a financial operation, exclusive of maneuvers effectuated outside the market (e.g., press campaign or dissemination of rumors).

It is also noteworthy that manipulation is a formal infraction since it is defined with respect to its object rather than its effect. It is therefore unnecessary to establish the causal link between the incriminated conduct and the result. It is irrelevant that the goal was not reached if the goal is questionable. However, even though the infraction is formal, a mere attempt remains punishable.

We must now define the term maneuver. This task is made more difficult because there are just a few decisions on the subject. We should note, however, that market disruption is caused by the transactions of those who have been misled, not by the maneuver itself. This exigency makes it possible to separate the infraction from other practices that are necessary for the maintenance of the stock. Thus, transactions of stock stabilization when a control block is discontinued do not meet the criteria laid down by article 10-3. When an operation is carried out in broad daylight with full disclosure, it cannot be a maneuver.⁸⁵

In the rare decisions involving securities manipulation, one must distinguish the cases dealing with the "boiler" technique which courts have likened to manipulation.⁸⁶ In fact this technique constitutes both a manipulation and a fraud.⁸⁷

84. 22d Rapport COB, Bull. July 1990, § 168, No. 23, at 616.

85. T.G.I. Paris, Mar. 5, 1993, RJDA 10/93, No. 813, BANQUE ET DROIT, No. 31, Sept.-Oct. 1993, at 23 note F. Peltier.

86. See cases cited *supra* note 23.

87. This technique consists of manipulation that raises the price of a stock

Regulation 90-04 was instituted to mitigate the difficulties associated with the constituent elements of the infraction. These elements are different from those in article 10-03. The term maneuver is not used, and two distinct facts constitute the infraction: bids that induce others into error, or bids that impair the pricing mechanism. While article 10-03 considers these two elements as inseparable components of the material element of the infraction, the COB regulation separates them into two distinct dealings, each being independently reprehensible. Despite this flexibility, the rule gave rise to only two decisions.⁸⁸ However, the text allows the COB to prosecute several cases. It may penalize every bid that did not respect market rules and it may prosecute open bidders in markets where such bids are not authorized or people are acting without qualification. Finally, it may also penalize perpetrators of passive manipulation, i.e., those who refrain from bidding when their previous position requires them to bid.

In the United States, the material element of the infraction is particularly important. The criteria differ according to which article is invoked as the basis of the prosecution. While section 9(a)(1) gives a clear description of the material element, sections 9(a)(2) and 10(b) are less precise since they seek to apprehend the largest number of manipulative practices. The material element in 9(a)(1) is particularly precise since it targets washed sales (transactions where the parties agree that title will not pass) and matched orders (where A buys 100 shares knowing that B is simultaneously selling 100 shares at the same price and with the knowledge that A is buying them), both of which create the deceptive appearance of activity in the market (note that such practices are not proscribed in France).⁸⁹ Section 9(a)(2), initially designed to combat pools (a syndicate of investors who combine efforts to manipulate securities or commodities),⁹⁰ has a material element of greater

whose market is narrow and sensitive by making a large number of bids with the goal of persuading investors of the imminence of a transaction, thus causing them to deal in the stock. The manipulator then sells at the higher values.

88. *Computel*, ICPU, Bull. COB 1992, No. 263; *Graslin*, Bull. COB No. 288, Feb. 1995, at 17; *BANQUE ET DROIT*, No. 42, July-Aug. 1995, at 29 chron. F. Peltier.

89. Lewis D. Lowenfels, *Sections 9(a)(1) and 9(a)(2) of the Securities Exchange Act of 1934: An Analysis of Two Important Anti-Manipulative Provisions Under the Federal Securities Laws*, 85 NW. U. L. REV. 698 (1991).

90. Comment, *Market Manipulation and the Securities Exchange Act*, 46 YALE

scope because it proscribes a large number of manipulative practices.⁹¹ Three elements must be present to establish a violation of article 9(a)(2): (1) a series of transactions on a stock quoted on a national stock market, (2) which leads, as the result of some action on the stock, to a hike or a drop in its price, (3) done with the goal to induce others to purchase or sell (the last condition will be developed in the next paragraph). The first condition should normally be restricted to purchases or sales actually made, but the SEC extended it to bids. The expression series of transactions is expansively construed; thus, 3 purchases in 2 consecutive days constitute a series of transactions.⁹² The infraction covers direct and indirect transactions as well as those carried out on one's own behalf or on behalf of others. The second element accounts for the impact of manipulation. There are two possible distinct consequences: either the creation of some activity on some stock, or a hike or drop in its price. Actual activity may be created, for example, by having a party buy the stocks and resell them to the defendant. However, the law does not proscribe every activity that may lead to a hike or a drop in stock prices; only those that seek to create artificial movement. Finally, factors such as domination and control of a stock's market, or its collapse when the manipulator ceases his activities, may adversely affect stock prices.

Thus the material element in section 9 is much more precise than the one in article 10-3. Moreover, in article 10b, the SEC laid down very broad rules. So did the COB in France in Rule No. 90-04 of article 10b-5. The purpose of this provision is to protect investors and promote a free and open stock market as well as ensure fair practices in the market.⁹³ This article applies to both sales and purchases of stocks. Because of its broad scope, (registered and unregistered stocks), practices that violate section 9 also violate article 10(b)(5). But the latter proscribes many more practices, since unlike 9(a)(2), it does

L.J. 624 (1937). For an excellent description of a pool, see LOSS & SELIGMAN, *supra* note 9, ch. 10, at 3941.

91. Normally restricted to the stock market, the scope of section 9 was broadened in *In re Wright* to encompass OTC markets. *In re Wright*, 3 S.E.C. 190, 213 (1938), cited in Lowenfels, *supra* note 89, at 698.

92. *In re Kidder Peabody & Co.*, 18 S.E.C. 559 (1945).

93. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

not require that the questionable transaction be made with the purpose of inducing others into error. However, a good faith investment that incidentally affects prices is not proscribed.⁹⁴ The Supreme Court adopted a narrow construction of the term manipulation in article 10(b)(5). In fact, *Ernst & Ernst v. Hochfelder* and *Santa-Fe Industries Inc. v. Green* both stand for the proposition that there cannot be manipulation without misrepresentation or nondisclosure.⁹⁵ The court also stated that failure to disclose manipulation constituted a violation of rule 10b-5.⁹⁶ Thus, the SEC can no longer penalize manipulative practices that are not deceptive.⁹⁷ The appropriateness of this position is subject to vigorous doctrinal debate. Some believe that the expansive interpretation of article 10(b) adopted by the SEC is more consistent with congressional intent, while others align themselves with the restrictive interpretation of the Supreme Court.

However, irrespective of the legislation, one cannot understand the material element without considering the moral element.

C. *The Moral Element: Key to the Problem?*

In France, the use of the term "knowingly" in article 10-3 of the 1967 Order indicates that the infraction could only be committed when acting in bad faith. The operator must have intended to impair the free functioning of the market.⁹⁸ The moral element was therefore essential. But since it was difficult to prove, prosecutions based on article 10-3 were rare. The requirement of an intent to disrupt the market was, in our opinion, the source of the ineffectiveness of this provision. In this respect, it is notable that rule 90-04 does not refer to any moral element, a fact which led some to suggest that the COB sought the "devitalization" of the infraction of securities manipulation.⁹⁹ Note also that the COB adopts an objective and

94. *United States v. Charnay*, 537 F.2d 341, 349 (9th Cir. 1976), cited in *McLucas & Angotti*, *supra* note 20, at 103.

95. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Santa Fe Industries v. Green*, 430 U.S. 462 (1977).

96. *Charnay*, 537 F.2d at 349, cited in *McLucas & Angotti*, *supra* note 20, at 103.

97. *Schreiber v. Burlington N. Inc.*, 472 U.S. 1 (1985).

98. Cass. crim., July 2, 1942, at 178.

99. A. Viandier & M. Jeantin, *REVUE DE DROIT BANCAIRE ET DE LA BOURSE*,

teleological interpretation of manipulation in order to escape the burden of proof imposed by article 10-3. In light of the reform effectuated by the Law of July 2, 1996, which leaves out the word "knowingly," must we now categorize the infraction of securities manipulation as a material infraction? Note that the test criminalizes a maneuver whose object is, rather than one whose effect is, the impairment of the regular functioning of the market. This would tend to suggest that securities manipulation was not necessarily transformed into a non-intentional infraction.

In the United States, section 9(a)(2) of the Exchange Act requires proof that the litigious transactions were made for the purpose of inducing the sale or purchase of a stock.¹⁰⁰ This, however, does not mean that a criminal or evil intent is required in order to violate this provision. In fact, proof of fraud is not even required.¹⁰¹ Courts have held that certain practices establish this manipulative intent, such as always making transactions at the beginning or close of sessions, or buying from a financial market and reselling over-the-counter. Moreover, this intent, which is even more important because it allows for a distinction between legitimate activity and manipulation, depends on the surrounding facts.¹⁰²

Unlike the preceding provision, section 10(b) and rule 10b-5 do not require proof of an intent to induce another to engage in a stock transaction. Nevertheless, scienter (defined by the courts as a mental state comprising an intention to deceive, manipulate, or defraud) must be proved.¹⁰³ Absent a Supreme Court decision on the subject, courts have tended to agree that mere negligence will not suffice. As is the case with intent, scienter may be indirect and can be proved by circumstantial evidence. Finally, failure to disclose manipulation is a violation of these articles; in fact, failure to disclose that prices are artificially affected corresponds to deception or omission of material facts.

No. 21, Sept.-Oct. 1990, at 204.

100. Poser, *supra* note 65, at 671.

101. Lowenfels, *supra* note 89, at 698; *accord* Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 795 (2d Cir. 1969), *cited in* McLucas & Angotti, *supra* note 20.

102. Comment, *supra* note 90, at 624. For a study of some judicial decisions, see McLucas & Angotti, *supra* note 20.

103. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

Note that the moral element is closely linked to the material element, and this is a result of the Supreme Court's interpretation. Thus, through an interpretation of the material element limited to deceptive fraudulent activities and by requiring proof of an intent to deceive or defraud, the Supreme Court considerably reduced the scope of manipulation. Consequently, the investor who cannot prove deception will not be entitled to damages. Faced with this situation, the Supreme Court and the SEC define deception as a very flexible concept.¹⁰⁴

D. Materiality and Reliance

When a stock has been manipulated, securities law grants the victim a right to restitution.

In France, one must join the penal prosecution as a civil party under article 10-3 of the 1967 Order. However, the investor need not prove, in addition to manipulation, that he would not have become involved had he had knowledge of the facts.

In the United States, on the other hand, in addition to the moral element of intent, one must prove materiality and reliance, both of which are the principal elements of the cause of action.¹⁰⁵ Although section 9(e) of the Exchange Act expressly provides for damages, section 10(b) does not. It was not until 1971 that the Supreme Court finally recognized an implicit private right of action under article 10(b)(5). And although the Court tried to limit its application, there is an increasing number of actions based on this cause of action.

For the action to be allowed, the victim must have either purchased or sold the manipulated stock. He must also prove scienter, materiality, and reliance. The test for materiality is whether a reasonable person would attach some importance to the distorted facts in his decision to engage in the transaction in question. Information thus plays a capital role in this respect since there are instances where the misinformation or nondisclosure may be considered material. Failure to disclose a reimbursement negotiation plan with respect to the plaintiff's

104. Lawrence Damian McCabe, *Puppet Masters or Marionettes: Is Program Trading Manipulative as Defined by The Securities Exchange Act of 1934?*, 61 FORDHAM L. REV. S207 (1993).

105. 2 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 13.5, at 86 (1990).

stock is deemed immaterial. On the other hand, a substantial reduction in dividends is considered material. Reliance is a corollary of materiality: the test is how the plaintiff would have acted had he had knowledge of the real facts. In other words, it must be established that he was actually induced in error. In light of the difficulty of proving reliance, courts have allowed a presumption of reliance which gave rise to the fraud-on-the-market doctrine.¹⁰⁶ Under this doctrine, as we explained in the first part, it is enough, to show reliance, that market prices have been affected by the false statement or the nondisclosure, and that the plaintiff's loss was due to the sale or purchase of the stock at the fraudulent prices.

E. Examples of Manipulation

The foregoing illustrates how complex and ambiguous the concept of manipulation is. Nevertheless, there is abundant jurisprudence on the subject. And although we may not provide an exhaustive list here, it might be interesting to name some examples of manipulative practices.

First of all, the best known is the boiler practice: a stock whose market is narrow and sensitive is manipulated rapidly to increase its price by making over-the-counter bids with the goal of persuading investors of the imminence of some operation. While investors contemplate an eventual price hike, the manipulator quickly sells his holdings, pocketing substantial profits in the process. It is also possible to arrange for the seller to announce a reasonable drop in dividends, which will then lead to a drop in the price of the stock, thus causing minority stockholders to sell at undervalued prices.¹⁰⁷ In cases of merger, it is possible to artificially raise the stock price of one of the companies for better merger parity.¹⁰⁸ Investors also use the "marking the close" technique where bids are made at the close of sessions. Since such bids are generally used to calculate the stock's variation for the next day's session, any action on the stock creates the appearance of a hike or drop in its

106. Note, *The Fraud-On-The-Market Theory*, 95 HARV. L. REV. 1143 (1982); De Simone, *supra* note 42, at S151; Macey & Muller, *supra* note 43, at 1059.

107. *Mutual Shares Corp. v. Genesco Inc.*, 384 F.2d 540 (2d Cir. 1967).

108. *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975).

market.¹⁰⁹ Over-the-counter markets are particularly sensitive to these types of practices.¹¹⁰ Finally, questions have been raised about the validity of two peculiar types of financial practices: transactions on substantial blocks of stocks and program trading. With respect to the first, studies have shown that prices may be disturbed by this type of practice.¹¹¹ With respect to program trading, a recent study indicates that the practice may be manipulative or not, depending on whether one relies on the legislature's session notes or the Supreme Court's decision.¹¹²

IV. EFFECTIVENESS OF THE PROHIBITION

The uncertainty attending the definition of securities manipulation and the difficulty in applying it raises some doubt as to its effectiveness and elicits suggestions that the infraction should be canceled (A). Moreover, on either side of the Atlantic, it has become apparent that damages are difficult to establish (B).

A. *A Controversial Proscription*

Some economists have proposed the elimination of any regulation that penalizes securities manipulation.¹¹³ Noting that there is no definition for manipulation, they conclude that manipulation is impossible. In fact, these economists contend that the requisite conditions must be met simultaneously in order to give rise to manipulation: the action on the market must lead to a price increase, and the manipulator must be able to sell at a higher price than the price at which he bought the stock. For manipulation to succeed, the manipulator must give the impression that he has or will obtain some information on the stock. But prices cannot be affected this way because of the flexibility of supply and demand and the substitu-

109. *United States v. Jefferies*, 87 Cr. (MEL) (S.D.N.Y. Apr. 16, 1987); *United States v. GAF Corp.*, 88 Cr. 415 (MJL) (S.D.N.Y. July 6, 1988); *SEC v. ZICO Investments Holdings, Inc.*, 87 Civ. 8487 (TPG) (S.D.N.Y. Dec. 2, 1987), cited in *McLucas & Angotti*, *supra* note 20.

110. Rogoff, *supra* note 60, at 147.

111. R.W. Holthausen & R.W. Leftwich, *The Effect of Large Block Transactions on Security Prices*, 19 J. FIN. ECON. 237 (1993).

112. McCabe, *supra* note 104, at S207.

113. Fischel & Ross, *supra* note 51, at 503.

tion that takes place. Moreover, if the manipulator seeks to convince someone that the information in his possession will lead to a price increase, it is very likely that the increase he is peddling derives simultaneously from the stock that he bought, in which case his profit is naught. Furthermore, the eventual manipulator may be faced with a liquidity problem that generates higher costs: because he wishes to purchase large blocks of stocks in order to raise prices, there may not be enough sellers to meet his demand. Consequently, the manipulator may buy at a higher price than the price at which he will eventually sell. Thus, since manipulation cannot be successfully carried out, it is described as self-detering.

To this impossible manipulation theory, the authors add the difficulty in identifying the practice, which results from the fact that the intention of the supposed manipulator is hard to determine. They deplore the fact that the law relies on objective facts to deduce bad intent. In other words, they deplore the fact that the law assimilates manipulative practices with conduct that has nothing to do with securities manipulation. A good example is when transactions are made before closing. These transactions are generally likened to manipulation because closing prices are deeply affected by last minute bids. But exchange rates are generally higher at the end of the day. Why then consider bids made before closing as manipulative?

This opinion has aroused strong reactions to the effect that even if manipulation is hard to discern, the irregular bidding may disrupt the normal pricing of a stock.¹¹⁴

In addition to disagreeing with the appropriateness of repressing securities manipulation, the doctrine also questions the evaluation of the resulting damages to the extent that the methods adopted by courts contravene economic theory.

B. Damages Are Difficult to Estimate

One of the difficulties raised by manipulative practices is the evaluation of damages.

In the United States, economic theory plays an increasingly important role in the process since it serves as the basis for calculating the manipulator's profits and the losses incurred

114. Steve Thel, *\$850,000 in Six Minutes—The Mechanics of Securities Manipulation*, 79 CORNELL L. REV. 219 (1994).

by the deceived investor. Some jurisdictions will terminate the contract. As a general rule, however, courts will impose out-of-pocket damages on account of the implied private right of action under article 10(b)(5). The difficulty of this approach resides in the computation of interest that accrued on the damages since this interest is based on the value of the stock at the time of the fraudulently induced purchase or sale. Generally, to compute these damages, American courts adopt the position that the price of a stock just before the discovery of the fraud reflects its price. Thus, it is appropriate to extrapolate the stock's value in time for every day that the deception remained undiscovered. Multiplying this difference by the number of stocks purchased or sold will give the amount of the damages. Some studies have suggested that this method of computing damages is not pertinent, especially when there are intervening external factors, like a crash, for example.¹¹⁵ Without going into the details of these studies, they suggest essentially that the correct estimation of damages should wait for a few days after the discovery of the fraud to allow the stock to regain a more realistic value and thus minimize the effect of the crash.

In France, there is no jurisprudence on the subject with respect to the infraction of securities manipulation. However, the solution adopted with respect to the infraction of dissemination of false information is instructive. The *Cassation* court held that damages incurred by stockholders subsequent to dissemination of false information is equal to the difference between the normal value of a stock and its value after the dissemination of the information.¹¹⁶ This solution, which seems logical if the damages may be presumed to be definite, is nonetheless criticized. Some have argued that it is harsh when applied to stocks purchased prior to the period under litigation.¹¹⁷ This solution may also be criticized for not taking into

115. Lev & de Villiers, *supra* note 41, at 7.

116. Cass Crim. Mar. 15, 1993, Bull. No. 113, at 280; Paris Dec. 18, 1995, *BANQUE ET DROIT*, No. 48, July-Aug. 1996, F. Peltier & H. de Vauplane, *chron.* Note that COB administrative penalties for a Rule 90-02 violation relative to public information do not take into account the damages to the stockholders. The violation does not seek to compensate for the damages, but rather to punish the dissemination of inaccurate and untrue information.

117. *Chambre commerciale et financière* [Cass. com.], Mar. 15, 1993, Bull. *Joly bourse*, July-Aug. 1993, § 76, at 365 note M. Jeantin; *REV. SOCIÉTÉS*, 1993, at 847

consideration the possible effect of a crash.

C. *Toward a Reform?*

Between unbridled liberalism and excessive punishment, is it not appropriate just to attempt to improve on existing provisions?

In the United States, the legislation seems particularly effective. However, it is necessary that the SEC and the Supreme Court agree over a single definition of manipulation. It is also necessary to combat manipulation more vigorously in markets such as OTC.¹¹⁸ However, the approaches to achieving these ends are split. Some have proposed a reform of article 10(b)(5) in light of the Supreme Court's position with respect to an implied right of action.¹¹⁹ Others believe that the best quality of article 10(b)(5) is its adaptability.¹²⁰ This provision is key to the American legislation. Thanks to its flexibility, it can adapt to evolving market techniques.

In France, despite the reform effected by the Law of July 2, 1996, the offense of securities manipulation remains useless. On one hand, its application is hindered by the moral element requirement, and on the other hand, it cannot, absent the incorporation of the fraud-on-the-market theory, address the effects on the free interplay of supply and demand. When a rule is ineffective, one may either make it more effective or one may discard it. If we opt for the first solution, we must admit, as is the case with insider infractions, that an infraction may be committed without requiring a culpable intent. In this case, the infraction is devoid of its essence, and the position is consistent with Lombroso's theory which purports that society is a body that must be rid of all cancerous cells, in other words, of every individual susceptible of deviant behavior. The second method seems more appropriate: the infraction has no real basis in law since it is a mere economic infraction without any

note B. Bouloc; see also H. Hovasse's notes, DR. SOCIÉTÉS, Sept. 1992, No. 14.

118. Rogoff, *supra* note 60, at 149.

119. David S. Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U. L. REV. 627 (1963); Adam F. Ingber, *10b-5 or Not 10b-5: Are the Current Efforts to Reform Securities Litigation Misguided?*, 61 FORDHAM L. REV. S351 (1993).

120. Donald C. Langevoort, *Rule 10b-5 as an Adaptive Organism*, 61 FORDHAM L. REV. S7 (1993).

moral component—it is more appropriate to substitute it with an administrative penalty. Under these conditions, it is preferable to empower an independent administrative body like the COB, which can adapt to changes in the market and modify its rules as quickly as the techniques change, with jurisdiction over the matter. Discarding the infraction and allowing the COB regulation to prevail presents another advantage: on one hand it will eliminate the duality of penalty and repressive authorities, and on the other hand, it will prevent dual penal and administrative prosecutions for the same case. Obviously, such evolution must be accompanied by a reinforcement of defense rights.

However, the legislature did not adopt this solution. Instead it opted to maintain the penal infraction but reduced its moral element to the barest minimum. Our skepticism as to the use of keeping a dual penalty, one administrative and the other penal, remains justified.