UDC 343.373
DOI 10.31733/2786-491X-2023-1-257-265

Dmytro KAMENSKY ©
D.Sc. in Law, Professor
(Berdyansk State Pedagogical University),
Ukraine

STOCK MARKET MANIPULATION AS A COMPLICATED WHITE-COLLAR CRIME: AMERICAN AND UKRAINIAN APPROACHES

Abstract. The article deals with the separate problems of the formation, interpretation and improvement of the provisions of domestic and American legislation on criminal liability for manipulation on the stock market. An author's attempt was made to determine the role of the criminal law in ensuring the proper functioning of the stock market. The main economic factors of the criminalization of actions consisting in manipulation on the stock market have been clarified. In the context of state mechanisms for regulating relations in the market economy, relevant regulatory provisions in Ukraine, the USA, and separately in the European Union are analyzed. Emphasis is placed on the legislation and law enforcement practice of the USA as the country that historically has the greatest practical experience of combating prohibited manipulative practices on the stock market.

According to the results of a critical comparison of the norms of the Criminal Code of Ukraine on stock market manipulation with the corresponding American ban, the casuistic nature and ambiguity of the content of the former was revealed. It was established that special regulatory legislation does not improve the situation on the markets, but on the contrary, creating legal uncertainty, repels potential investors in securities.

It was also concluded that the current version of the CC regarding manipulation on the securities market is casuistic (a general meaning is given to an individual case without proper generalization), vague (which is an inevitable consequence of overly imprecise wording) and difficult to understand (confusing). The correct direction of de lege ferenda is recognized as a radical simplification of the criminal law, with observance of both established traditions of domestic legislative technique and effective practices of regulation of stock market relations in economically developed countries.

Keywords: *criminal offense, stock market, manipulation, information, securities, deception, public danger.*

Introduction. After several centuries of gradual development, a few crises and several financial turmoils, stock markets are no longer associated in public mind merely with the artificial capital, and while serving as basis for the market economy, have become real mechanisms for attracting investment, evaluating proprietary rights for assets.

Indeed, over the past three decades, the history of stock market establishment and development in Ukraine has provided numerous examples of the global best practices' transfer with regards to stock exchanges' supervision and organization, depository and clearing infrastructure etc. However, in reality, though stock market is the driving force of the global

© Kamensky D., 2023
ORCID iD: https://orcid.org/0000-0002-3610-2514
dm.kamensky@gmail.com

economy, it poorly performs the functions of deployment, allocation and channeling financial resources into Ukraine with the goal of stimulating economic growth and attracting foreign investment. Despite a few positive examples of integration into global capital markets (in particular, the recent provision with the access to the Ukrainian state bonds for foreign investors via the Clearstream international depository and also admission of the U.S. Treasury Bonds and Apple stocks into Ukraine), Ukrainian stock market has been plagued by significant distortions and imbalances, it remains underdeveloped and unattractive for both domestic and foreign investors. This is clearly evidenced by economic data collected in the course of the past several years (Kamensky et al., 2020, p. 1680).

Legitimate price-making on organized financial markets has always been a key condition for their normal functioning and stable development. Focusing activities of market participants on the natural fluctuations of supply and demand contributes to their smoothing and indicates the balance of the market. In this regard, a necessary condition for the formation of an adequate market price is free competition between counterparties, that is, the functioning of a competitive stock market. Instead, manipulation of prices on the securities market as a targeted influence on the financial market disrupts its stability, leads to its "rocking", the formation of artificial prices and the emergence of economic disparities, and also allows obtaining, obviously at the expense of misleading other market actors, of unjustified profits, while causing material damage to its participants and third parties.

Analysis of recent research and publications. Various criminal law aspects of stock market manipulation as a white collar criminal offense have been actively studied by such Ukrainian criminal law scholars such as P. Andrushko, O. Dudorov, R. Movchan, Ye. Streltsov, R. Volynets.

Among American commentators, who have addressed specific issues related to American stock market manipulation, one can name S. Buell, C. Dice, L. Dervan, F. Peccora, E. Podgor, N. Poser, S. Thel and many others.

The author of this article has also previously written that the development of the stock market is determined by a number of factors, including the state of legislative support of countermeasures against relevant offenses. Crimes and other torts on the stock market (distribution of manipulative and insider practices nature, issuance of "junk" securities, fictitious emissions, etc.) create grounds for mistrust on the part of investors, increase investment risks and, as a result, worsen investment climate, complicate formation of a modern market economy in Ukraine, encroach on the interests of the owners of securities and other stock market participants, contribute to the laundering of "dirty" income, etc. (Kamensky & Dudorov, 2019, p. 185).

Under such circumstances, there is no doubt about the necessity to ensure proper functioning of the Ukrainian stock market, including high-quality criminal law "tools" and with the help of better understanding of how stock market functions and is being protected in Western economies.

The research paper's objective is to determine, within comparative method framework, legal grounds and implications of the statutory provisions on stock market manipulation under Ukrainian and American criminal law. Collaborating on a set of pragmatic conclusions is also an objective for this paper.

Formulation of the main material. Among the most criticized aspects of the previous model of the stock market (which existed before the Great Depression) was the monstrous manipulation of stock prices. The vast majority of criticisms of stock exchanges and brokerage firms made during the Senate investigation of 1933-1934 were based on documented cases of full-scale manipulation. The very drafting of the Securities Act of 1934 was largely determined by such manipulations. The adoption of any new law in this area does not mean that individuals will not try to find loopholes, which will allow them to violate it with impunity, or will not invent fundamentally new ways that are not addressed by the law, and therefore do not fall under its influence.

Against the background of the events described above, American (and also global) financial crisis of 2008-2009, associated with full-scale speculation in the field of mortgage lending, should be considered as and event, which already had a sad precedent in the history of the development of the American stock market. Probably those harmful, so to speak, dark forces of the stock market, reinforced by self-serving motives and the desire to obtain quick extra profits, which preceded the stock market crash of 1929 and the Great Depression associated with it, and which F. Pekora, the former chief of the Stock Exchange Commission, mentioned in his famous treatise, again received their manifestation – already in a different macroeconomic environment, under other normative "coordinates" of federal regulation and in a different society, but, nevertheless, with a similar system of determinants and a similar intensity (Pecora, 1939).

A few words about the relevant European experience. The agreement on the association of Ukraine with the EU in terms of stock market reform stipulates that our country will ensure the gradual alignment of its current and future legislation in this area with EU norms. European acts, which directly relate to criminal and administrative law in matters of market abuse are EU Directive No. 2014/57/EU of April 16, 2014 "On criminal sanctions for market abuse" (hereinafter – Directive 2014/57) and the Regulation of the European Parliament and Council No. 596/2014 dated April 16, 2014 “On market abuse”.

Art. 5 of Directive 2014/57 reveals key elements of criminally punishable market manipulation. These include: a) entering into a deal, placing an order to trade, or any other activity that: (i) provides false or misleading signals as to the supply, demand, or price of a financial instrument or commodity spot contract; (ii) secures the price of one or more financial instruments or a commodity spot contract at an abnormal or artificial level; except in situations where the reasons for such activity for the person who executed the transaction or trade order are lawful and those trade agreements or orders are in accordance with accepted market practice at the place of trade; b) entering into an agreement, placing an order to trade or any other activity or conduct that affects the price of one or more financial instruments or a commodity spot contract that uses a sham method or any other form of deception; c) dissemination of information through mass media, including the Internet, or by any other means, which gives false or misleading signals about the supply, demand for, or price of a financial instrument or commodity spot contract, or keeps the price level of one or more financial instruments or a commodity spot contract at an abnormal or artificial

level, if the persons who made such dissemination receive for themselves or another person a benefit or profit from the dissemination of such information; or d) transmitting false information or making false or misleading statements or any other activity which manipulates calculation of the benchmark (https://eur-lex.europa.eu).

Overall, the possibility that stock markets (both developed and emerging) can be manipulated is an important issue for the regulation of trade and the market efficiency. One of the reasons the Securities and Exchange Commission (SEC) was established by Congress in 1934 was to eliminate stock market manipulation. While manipulative activities seem to have declined on the main exchanges, it is still a serious issue in the over-the-counter (OTC) market in the United States as well as in emerging financial markets.

American researchers correctly refer to the fact that manipulation can occur in a variety of ways, from actions taken by insiders that influence the stock price (e.g., accounting and earnings manipulation such as in the Enron case) to the release of false information or rumors in Internet chat rooms. Moreover, it is well known that large block trades can influence prices. For example, by purchasing a large amount of stock, a trader can drive the price up. If the trader can then sell shares and if the price does not adjust to the sales, then the trader can profit. Of course, one should expect that such a strategy would not work. Selling shares will depress the stock price, so that, on average, the trader buys at higher prices and sells at lower prices. This is the unraveling problem, which seems to rule out the possibility of trade-based manipulation (Aggarwal & Wu, 2006, pp. 1915-1953).

From a legal point of view, price manipulation is a manifestation of unscrupulous business practices on the securities market and, at the same time, a type of stock market offense. In essence, manipulation of the securities market creates an impact on the exchange rate (calculated) price of assets that circulate on the stock market, due to short-term or long-term transactions of a large volume. At the same time, it is necessary to realize that given the existing gaps in the current legislation, certain methods of manipulation may be recognized as completely legal. In addition, manipulation of the securities market is an extremely latent crime, and in practice it is difficult to establish all legal features of its composition.

It is also important to realize that artificial price control and not illegality is the key feature of manipulation. Manipulation in the securities market can generally be interpreted as the action of any participant or group of participants aimed at establishing artificial price control, which includes purchase and sale of securities with the purpose of creating a false or misleading appearance of active trading or with the aim of raising or lowering price in order to encourage other market participants to buy or sell a security, which, in turn, leads to a purposeful change in the exchange rate of the stock instrument in relation to its normal indicator (Savyn, 2010, pp. 52-54).

In other words, this is an artificial, "manipulator" controlled hype around the instruments which rotate in the stock market (Kamensky, 2018, pp. 42-46).

It is worth mentioning that in American regulatory laws the term "manipulation", which has historically been subject to interpretative inquiry by courts and law enforcement agencies, has not yet received a unified interpretation. The legislative history, which in the US has traditionally been

adhered to by both law enforcement agencies and directly interested participants in legal relations, demonstrates that the US Congress passed both Securities Acts seeking to realize two main goals: first, to protect legitimate interests of those investors (i.e., owners of securities papers), who were deprived of their monetary contributions due to the stock market crisis of 1929 and, secondly, to protect the public interest by preventing cases of "stock" fraud, as well as preventing other dubious manipulative schemes in the stock market, which lead to the emergence, exacerbation and the prolongation of various economic cataclysms, which, in turn, negatively affect national economic security and general well-being of society (Thel, 1990, p. 392).

I. Klepytskyi's points out that in the USA, as well as in Europe, the norms on market manipulation actually complement the norms on fraud. They are especially relevant and remain in demand in situations where there are no certain signs of fraud (established material damage, selfish or other personal interest, a causal connection between the act and the damage caused) or it is impossible to prove offense elements within the limits of criminal proceedings. The very fact of price and market manipulation requires application of criminal punishment. Instead, domestic ban enshrined in Art. 222-1 of the Criminal Code, does not fulfill, as it seems, its main task, which is more or less successfully implemented by its foreign "analogues": it does not fill the gaps in the provision on fraud, taking into account the specifics of securities trading on the stock market (Klepitsky, 2016, p. 97).

Now directly to the issue of specific American legislation and its practical implementation. As one can see, the boundaries between criminal and civil liability for violation of securities legislation in the USA are somewhat blurred and not specified enough. Taking this into account, and also referring to the fact that in the American judiciary it is a common practice to consider a criminal and a civil offense at the same time, using a single "set" of legal grounds, we are witnessing somewhat confusing, insufficiently specified and at the same time strict mechanisms for bringing violators of the stock market to legal liability. The confrontation between the accused (the defendant) and the prosecutor (the court) often acquires imprecise characteristics in the process of investigating white-collar crime, because a person can enter into a plea agreement, and in the event of a guilty verdict, he can be punished conditionally, not very severely, or vice versa, within the maximum amount allowed by the corresponding sanction. Against such background, legislative description of dispositions and sanctions of Art. 222-1 and 232-1 of the Criminal Code looks more clear and predictable for application than the "confused" (vague) approach by the American legislator.

A little bit of relevant legal history here. In 1942, attention of the lawyers of the Boston regional branch of the SEC was drawn to the activities of a businessman who made statements with negative forecasts about the company's earnings, while simultaneously buying its shares. However, the Securities Act of 1933 provided for liability for fraud in the sale of shares, but not in their purchase. Prosecuting such swindler for common fraud was problematic. As a result, based on Art. 10 of the Stock Exchange Act of 1934, the US Securities and Exchange Commission has approved Rule 10b-5.

Rule 10b-5 enacted in order to implement and detail § 10(b) of the Act prohibits, inter alia, engaging in any act, practice, or course of business conduct

that would constitute fraud or deception against any person. As we can see, such prohibition is extremely vague in its content. In contrast to Art. 9 of the Act of 1934, which indicates intentional behavior, this rule does not even specify the form of a person's subjective attitude to the committed act.

In general, the practice of applying Rule 10b-5 is instructive and leads to the following conclusion: it is extremely difficult to formulate the most understandable and at the same time clearly defined prohibition in the field of economic fraud, especially fraud on the stock market. Such legal drafting requires patience and consultations both with law enforcement members and market participants.

Pursuant to § 240.10b-5 of Title 17 of the USCFC, any person who uses a deceptive scheme or makes a false statement or withholds material information in connection with the purchase or sale of securities is subject to criminal or civil liability. Criminal prosecution under § 10(b) of the 1934 Act and Rule 10b-5 requires establishment of mandatory elements, which are similar in principle to the elements of the corresponding civil offense. Thus, for a successful civil action based on the provisions of Rule 10b-5, the court must establish that the defendant: 1) distorted or concealed; 2) a material fact; 3) knowingly; 4) in connection with the purchase or sale of a security; 5) that the plaintiff openly relied; 6) such reliance probably caused material damage to the plaintiff. If these mandatory elements of a civil action are present, a criminal prosecution on the same grounds may be instituted under § 32(a) of the Act of 1934, cited above, if the prosecution has evidence that the wrongdoer's actions were intentional.

From the standpoint of determining the grounds for the application of criminal liability, one should consider such a widespread scheme of manipulation as "marking the close". A trader immediately before the end of trading buys (or sells) a security at an overestimated (or underestimated) price. As a result, market participants (or special market software bots with participant identification technology) receive false information about the value of the security, which can lead to an erroneous operational decision and, as a result, cause material losses. The next day, another trader sells such security at an inflated price, sharing the profit with the "manipulator" (or giving some other kind of reward) (Hammel & Malionek, 2007, p. 281).

Actions become even more dangerous when trade takes place "on the decline" and is accompanied by aggressive short sales. It is extremely difficult to classify such activity as fraud, and in most cases it is impossible to prove it at all. In addition, it should be taken into account that speculation in the market is generally a useful thing, because it ensures liquidity of assets. At the same time, as a rule, a deal profitable for one participant turns out to be a loss for another – it is obvious that new funds are not created by the participants. No less obvious is the fact that a bidder seeks to make a profit and at the same time foresees the inevitability of losses for another bidder.

And now to the Ukrainian side of the issue at hand. The objective element of the crime provided for in Art. 222-1 of the Criminal Code, consists of taking actions that have elements of manipulation on the stock exchange. At the same time, elements of such actions must be established by the law on state regulation of the securities market. Currently, this is the Law "On State Regulation of the Securities Market in Ukraine". According to Art. 10-1 of this Law, the following

actions, among others, have been recognized as price manipulation on the stock market: 1) carrying out or attempting to carry out operations or submitting an application for the purchase or sale of financial instruments that provide or can provide information about the supply, purchase or price of a financial instrument, which do not correspond to reality, and are committed individually or by a group of persons and lead to the establishment of prices other than those that would exist in the absence of such transactions or bids; 2) carrying out or attempting to carry out transactions or submitting an application for the purchase or sale of financial instruments by committing intentional illegal actions, including fraud or use of insider information; 3) dissemination of information through mass media, including electronically, or by any other means, which leads or may lead to misleading market participants regarding the price, demand, supply or trading volumes of financial instruments on the stock exchange, which do not correspond to reality, in particular, the dissemination of inaccurate information, in the event that a person, who has disseminated such information, knew or should have known that such information was inaccurate; 4) purchase or sale of financial instruments before the closing of the trading session of the stock exchange in order to mislead market participants regarding the prices that have developed at the end of the trading session; 5) repeatedly during the trading day carrying out or attempting to carry out operations or submitting an application for the purchase or sale of financial instruments that do not have an obvious economic sense or an obvious legal purpose, if the owner of such financial instruments does not change as a result of such trading.

It becomes obvious that such regulatory material is too difficult to understand. The use of vague wording in it such as "attempt to carry out transactions", "obvious economic sense", "substantial deviation from the price" definitely does not help with the effective application of Art. 222-1 of the Criminal Code. In accord with this, V. Gatselyuk writes that the description of the considered criminal law ban does not correspond to the established methods of legislative technique and the principles of criminal law (Gatselyuk, 2011, pp. 103-107).

Conclusions. Several general conclusions can be drawn from the material presented in this article.

First, a critical comparison of the rule of the Criminal Code of Ukraine on stock market manipulation with the corresponding American ban reveals the casuistic nature and content ambiguity of the former. Special legislation here does not improve the situation on the markets – on the contrary, by creating legal uncertainty, repels potential investors in securities. Therefore, correct approach would be simplification of the wording of Art. 222-1 of the Criminal Code, following the canons of the domestic legislative technique, and its application as a practice in economically developed countries with a powerful stock market, namely: to be guided not only by formulas and methods of determining manipulative signs, but primarily by pragmatic considerations about ensuring normal operation of the stock market, its protection against illegal encroachments.

Second, in the USA, over a period of more than 80 years, at the legislative, law-enforcement, and doctrinal levels, considerable experience has been gained in countering stock manipulation abuses, in particular, a separate category of court precedents has been formed, which law enforcement officers are guided

by. This experience is worth a careful study on the issue of borrowing by Ukrainian theory and practice, with mandatory consideration of the fact that Ukraine belongs to the Romano-Germanic legal system with its distinct features. In particular, American model of criminal law protection of stock market relations is characterized by the fact that federal legislation does not contain a single criminal law prohibition with a defined content, capable of more or less clearly describing the elements of manipulation abuse, essentially giving away this necessary in each case specifics on the "buy-back" of the rule-making of the SEC, as well as the precedent practice of federal courts. The latter interpret, apply and oblige the participants of the relevant legal relationship to interpret regulatory rules of the SEC on manipulative practices as *de facto* criminal law prescriptions. This, as it seems, is the key difference between the American practice and the pan-European and, in particular, domestic approaches, which provide (with varying degrees of specification) for establishing crime-related elements of manipulative behavior exclusively within the limits of a separate norm of the national criminal law.

Finally, a general conclusion is suggested that the current enforcement of the Criminal Code on market manipulation is casuistic (an individual case is given a general meaning without proper generalization), futile (as an inevitable consequence of too imprecise wording) and unclear (confused). And therefore, the only correct direction can be a radical simplification of the criminal law, following the established traditions of the domestic legislative technique, and its application in the way it is done in economically developed countries with a powerful stock market – namely, to be guided by non-mathematical formulas and methods of determining signs of manipulation, and above all common sense and pragmatic goals in terms of ensuring normal operation of the stock market.

Conflict of Interest and other Ethics Statements
The author declares no conflict of interest.

References

Aggarwal, K. & Wu, G. (2006). Stock Market Manipulations. *The Journal of Business*, 79 (4), pp. 1915-1953.

Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive). URL : https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=uriserv:OJ.L_.2014.173.01.0179.01.ENG.

Gatselyuk, V. (2011). Ryzyky blanketnoho sposobu vyznachennia oznak obiektyvnoi storony skladu zlochynu (v konteksti kryminalizatsii manipuliuvannia na fondovomu rynku) [Risks of the blanket method of determining the signs of the objective side of the crime (in the context of the criminalization of stock market manipulation)]. *Kryminalnyi kodeks Ukrainy: 10 rokiv ochikuvan:* tezy dopovidei ta povidomlen uchasnykiv Mizhnarodnoho sympoziumu, 23-24 veresnia 2011 r. Lviv: Lvivskyi derzhavnyi universytet vnutrishnikh sprav, pp. 103-107.

Hammel, J. & Malionek, R. (2007). Is "Deceptive" Conduct Only Misstatements or Omissions? *New York Law Journal,* vol. 88, pp. 278-289.

Kamensky, D., Dudorov, O., Movchan, R., Voznyuk, A. & Makarenko, T. (2020). Insider trading in the global economic environment: elements of criminal liability. *International Journal of Management,* 11 (12), pp. 1679-1688.

Kamenskyi, D. (1990). Zakonodavstvo ES pro vidpovidalnist za pravoporushennia na fondovomu rynku: aktualnyi dosvid [EU Law on liability for stock market offenses: current experience]. "*Aktualni problemy prava ta shliakhy yikh vyrishennia" :* Zbirnyk

materialiv Vseukrainskoi naukovo-praktychnoi internet-konferentsii Kalmiuski pravovi chytannia. 10 hrudnia 2018 r., Mariupol: DonDUU, pp. 42-46 [in Ukr.].

Kamenskyi, D. & Dudorov, O. (2019). Insaiderska informatsiia ta kryminalnyi zakon: vid amerykanskykh realii do ukrainskykh perspektyv [Insider information and criminal law: from American realities to Ukrainian perspectives]. *Yurydychnyi naukovyi elektronnyi zhurnal*, 3, pp. 185–201. URL: http://www.lsej.org.ua/3_2019/52.pdf. [in Ukr.].

Klepitskiy, I. (2016). Market manipulation: the law does not work. *The Law,* vol. 10, pp. 92-98.

Pecora, F. (1939). Wall Street Under Oath: The Story of Our Modern Money Changers. New York: Simon and Schuster, 311 p.

Savin, A. (2010). Fighting with insider trading and market manipulation. *Stock Market,* vol. 2, pp. 52-54.

Thel, S. (1990). The Original Conception of Section 10(b) of the Securities Exchange Act. *Stanford Law Review*, vol. 42, pp. 385-464.

Дмитро КАМЕНСЬКИЙ

МАНІПУЛЮВАННЯ НА ФОНДОВОМУ РИНКУ ЯК СКЛАДНИЙ БІЛОКОМІРЦЕВИЙ ЗЛОЧИН: АМЕРИКАНСЬКИЙ ТА УКРАЇНСЬКИЙ ПІДХОДИ

Анотація. У роботі розглядаються окремі проблеми становлення, тлумачення і вдосконалення положень вітчизняного та американського законодавства про кримінальну відповідальність за маніпулювання на фондовому ринку. Зроблено авторську спробу визначити роль кримінального закону в забезпеченні належного функціонування фондового ринку. З’ясовано основні економічні чинники криміналізації дій, які полягають у маніпулюванні на фондовому ринку. У контексті державним механізмів регулювання відносин ринкової економіки проаналізовано відповідні нормативні положення в Україні, США та окремо в Європейському Союзі. Наголос зроблено на законодавстві і правозастосовній практиці США як країни, яка історично має найбільший досвід практичної протидії забороненим маніпулятивним практикам на фондовому ринку.

За результатами критичного порівняння норм КК України про маніпулювання на фондовому ринку з відповідною американською забороною було виявлено казуїстичний характер і неоднозначність змісту першої. Установлено, що спеціальне регулятивне законодавство не покращує ситуацію на ринках, а навпаки, створюючи правову невизначеність, відштовхує потенційних інвесторів у цінні папери.

Також було сформульовано висновок про те, що нинішня редакція КК щодо маніпулювання на ринку цінних паперів є казуїстичною (окремому випадку надається загальний зміст без належного узагальнення), невизначеною (що є неминучим наслідком надто неточних формулювань) та складною для сприйняття (заплутаною). Правильним напрямком *de lege ferenda* визнано радикальне спрощення кримінального закону, із дотриманням як усталених традицій вітчизняної законодавчої техніки, так ефективних практик регулювання відносин фондового ринку в економічно розвинутих країнах.

Ключові слова*: кримінальне правопорушення, фондовий ринок, маніпулювання, інформація, цінні папери, обман, суспільна небезпека.*

Submitted: 14.02.2023
Revised: 24.03.2023
Accepted: 07.04.2023