

FUTURES MARKET REGULATION IN AUSTRALIA: WHAT IS IT TRYING TO ACHIEVE?

PAUL LATIMER*

I. SYNOPSIS

In a seminal article in Volume 5 of the U.N.S.W. Law Journal in 1982,¹ Mr Remo Giuffre reviewed the regulation of the commodity futures market in Australia as it operated before the passing by the federal and State governments of the predecessor to the Corporations Law in force from 1 January 1991, the *Futures Industry Act* 1986 (Cth) and equivalent State Codes. The author, critical of the high level of government regulation of the market in the U.S. and the apparent weaknesses of industry self-regulation in Australia as it stood in 1982, supported effective co-regulation by the industry and government. This indeed has been the trend of company and securities markets regulation in Australia since the commencement of national regulation in 1980. The

* Associate Professor of Law, Department of Accounting and Finance, Monash University, Melbourne. An earlier draft of this paper was presented at LAWASIA's 11th Conference in Hong Kong on 19 September 1989. The author acknowledges the helpful comments offered on the draft of this paper by A.J. Dreise, General Manager - Compliance and Counsel, Sydney Futures Exchange; Michael G. Hains, solicitor, Ebsworth & Ebsworth, Sydney, and Barry Oliver, Department of Accounting and Finance, Monash University, but of course accepts full responsibility for this paper.

1 R. Giuffre, "Regulation of the Commodity Futures Market in Australia" (1982) 5 *UNSWLJ* 170.

following article provides a policy analysis of Australia's co-regulatory regulation of futures markets since 1986. It concludes that the co-regulation, drawing upon the expertise and enforcement of the industry and enforcement by government has proved to be a cost-effective means of regulation drawing upon the resources of all parties involved.

II. FUTURES MARKET REGULATION

After a lengthy period of consultation, the predecessor to the Corporations Law, the *Futures Industry Act* 1986 (Cth) and equivalent State Acts (called the Futures Industry Code - hereafter F.I.C.) became law throughout the six Australian States and two federal Territories between 1st July 1986 (N.S.W., Victoria, A.C.T.) and 1st June 1987 (Tasmania). The call for regulation was largely market-led² by the Sydney Futures Exchange and the futures and securities industry as a response to a negative reputation gained by the industry from certain well-publicised failures, malpractice and fraud among certain futures brokers in the 1970's and the 1980's particularly relating to non-member non-Sydney Futures Exchange transactions.³ Hence, in the words of the Federal Attorney-General's second reading speech:⁴

The Futures Industry Bill will establish a framework applying prudential controls to participants in the futures industry. Briefly, the Bill will require futures brokers and advisers to be licensed; establish a system for the approval of futures

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- 2 Cf. E.F. Frohlich, "Some Features and Legal Aspects of the Futures Industry" (1986) 60 *ALJ* 224, pp. 229-230.
 - 3 E.g. G. Walker, "Future Shock: Corporate Collapse, Malpractice and Fraud in the Australian Futures Industry" (1986) 2 *Massey Journal of Asian and Pacific Business* 23.
 - 4 Lionel Bowen, M.H.R., Hansard, Commonwealth of Australia, House of Representatives, 16th April 1986, p.2361. See, e.g. T. Dreise, "New Futures Industry Legislation" (1986) 60 *LJ* 944. The *Corporations Act* 1989 (Cth), assented to on 14 July 1989, but declared unconstitutional in part by the High Court on 8 February 1990 in *New South Wales v The Commonwealth* (1990) 64 *ALJR* 157, incorporated the F.I.C. into the Commonwealth Act as Chapter 8 (ss.1120-1273). This Act was replaced by a revised Commonwealth/State/Territory co-operative scheme in the form of the "national scheme for companies and securities regulation" agreed to at the Ministerial Council meeting in June 1990. The *Corporations Act* 1989 (Cth), assented to on 18 December 1990, was reduced to 81 sections of covering clauses for the *Corporations Law* of 1362 sections contained in its s.82 which came into force on 1 January 1991. The *Corporations Law* essentially rennumbers the sections of the now-repealed companies and securities legislation including the *Futures Industry Act* 1986 (Cth) and State Codes. The *Australian Securities Commission Act* 1989 (Cth) (the ASC Law) assented to on 27 June 1989 and partly in force on 1 July 1989 (fully in force as amended 1 January 1991) in establishing the Australian Securities Commission (hereafter ASC) carries forward many of the provisions of the *National Companies and Securities Commission Act* 1979 (Cth) which it has ultimately replaced.

exchanges and clearing houses; require futures exchanges and futures associations to establish a fidelity fund for the protection of clients; provide criminal sanctions for manipulative and fraudulent practices; and require futures brokers to maintain adequate records and separate client funds from their own funds.

The basic purpose of regulation of futures markets is to ensure fair, competitive and orderly markets.⁵ In particular, Australian law regulating both the securities industry and futures industry and the futures industry seeks to achieve uniformity in the relevant laws and their administration throughout Australia's nine jurisdictions in order "(a) to maintain, facilitate, and improve, the performance of ... futures markets, in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and (b) to maintain the confidence of investors in ... futures markets by ensuring adequate protection for such investors".⁶ The legislation therefore seeks to provide some control to protect users of the futures markets, commodity producers, and the futures markets themselves.

The law regulating the Australian futures industry consists of the Corporations Law (and primarily Chapter 8 headed "The Futures Industry");⁷ other legislation where applicable such as the *Trades Practices Act 1974* (Cth); criminal statutes; the Memorandum of Association, Articles of Association and the By-Laws of the Sydney Futures Exchange, the Australian Financial Futures Market (hereafter AFFM) and the International Commodities Clearing House (hereafter ICCH) and the general law (contract, tort, trusts, agency etc). It is administered co-operatively by co-regulation (1) the overriding statutory authority of the federal statutory body, the Australian Securities Commission (hereafter ASC); (2) co-regulation between the ASC and the self-regulatory organisations, and (3) self-regulation based on the Articles and By-Laws of the self-regulatory bodies (which are in any case first approved by the ASC).⁸

This regulation replaces the previous scheme of self-regulation administered by the Sydney Futures Exchange under its previous name the Sydney Greasy Wool Futures Exchange Ltd. (formed in 1960; name changed in 1975) which was found unsatisfactory because of its lack of reach to non-members; its lack of reach to non-Sydney Futures Exchange transactions and its lack of statutory backing.⁹ Indeed, the failings of self-regulation of any industry or group are

5 E.g. United States General Accounting Office, *Securities and Futures. How the Markets Developed and How They Are Regulated*, Washington, D.C., 1986, p. 62.

6 *Australian Securities Commission Act 1989* (Cth), s.1(2).

7 In force from 1 January 1991: note 4, *supra*.

8 For example, to obtain a futures broker's licence from the ASC an applicant must be a member of an approved Futures Exchange of Futures Association (see text accompanying note 12 *infra*).

9 It also builds on and supercedes the Australian prototype *Futures Market Act 1979* (NSW).

legion.¹⁰ Essentially, as exchanges are monopolistic institutions which restrict membership and deny access to non-members, the responsibility of the self-regulators naturally inclines towards their fellow members instead of the public at large.¹¹

Hence the Australian legislation provides for the legal structure within which the futures industry operates. A "futures exchange", a "clearing house"¹² and a "futures association" will be approved by the Minister¹³ essentially if it has the capacity to self-regulate and to maintain orderly and fair markets.¹⁴ Recognising the rapid technological changes and the internationalisation of capital markets, the Corporations Law also allows specialised markets confined to professional and institutional investors with specialised knowledge of the market to be exempted from the legislation as an "exempt futures market".¹⁵

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- 10 They were alluded to by economist Adam Smith in the eighteenth century: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary." Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1.
- 11 H.S. Houthakker, "The Regulation of Financial and Other Futures Markets" (1982) 37 *The Journal of Finance* 481, 482. The failings of self-regulation of the Australian securities markets in the mining boom of the late 1960's were documented by a federal government Commission of Inquiry, which was the catalyst for Australia's co-operative scheme of co-regulation of the securities industry: Senate Select Committee on Securities and Exchange, *Australian Securities Markets and their Regulation* A.G.P.S., (1974) (The Rae Report).
- 12 The *Corporations Law* s.9 defines a "clearing house" as an entity that provides "clearing house facilities" as defined *loc.cit.* to its members, i.e. facilities for the registration of futures contracts made on the futures market. The Sydney Futures Exchange has appointed as clearing house the International Commodities Clearing House Ltd. (hereafter ICCH), a company based in London owned by a consortium of British banks, discussed in Part VII, *infra*. It intends to establish its own clearing house in 1990-1991.
- 13 *Corporations Law* ss.1126, 1131, 1132 respectively.
- 14 *Corporations Law* s.1137.
- 15 *Corporation Law* s.1127. Exemptions were granted by the former National Companies and Securities Commission (hereafter NCSC) in 1986-1987 to futures markets conducted by Macquarie Bank (for forward precious metals) and by Harlow Butler (Australia) Pty. Ltd. (transferable cash hedge contract): National Companies and Securities Commission, *Eighth Annual Report and Financial Statements*, 1986-1987, 42. In 1987-1988, an exemption was granted for the market for precious metals conducted by Rothschild Australia Limited: NCSC, *Ninth Annual Report and Financial Statements*, 1987-1988, 44. Those exempted earlier include Loco-London Bullion Market for Deferred-Delivery Gold and Silver

The futures legislation, in seeking to regulate all categories of futures contracts, recognises that a futures contract is neither a security nor an asset with monetary value but is instead the right of the investor with a deliverable or non-deliverable contract to profit from favourable moves in the market.¹⁶ It recognises the primary purpose of futures contracts¹⁷ is to enable the farmer, producer etc. to manage risks associated with commodity price fluctuations (to hedge), and to enable the trader or speculator with no physical commodity to gain (or lose) through forecasting of price movements (to speculate). As such, a futures market provides a venue for risk management for hedgers (risk avoiders) and for speculators (risk takers) and in so doing leads to collection and dissemination of information and to price discovery.¹⁸

The Corporations Law s.72 contains a wide definition of a "futures contract" to cover existing forms,¹⁹ to catch new contracts that may be developed and to ensure that all trading in futures contracts is subject to similar prudential requirements.²⁰ It excludes deliverable commodity options not traded on a futures exchange and physical commodity sales.²¹ Under the definition of a "futures contract"²² currency and interest rate swaps and forward exchange rate and forward interest rate contracts to which a bank or a merchant bank is a party are excluded on the basis that parties with specialised knowledge or a market

Contracts, the forward precious metals contract market operated by Rothschild Australia Ltd. for gold and silver producers, and Mase-Westpac.

16 With a corresponding obligation to pay unfavourable moves.

17 E.g. B.A. Goss, "Feasibility and the Consequences of Using Information in Futures Markets" in B.A. Goss, *Futures Markets: Their Establishment and Performance*, London, Croom Helm, 1986, p.2.

18 I.e. through individuals trading on private and public information, prices are established by the auction process on the exchange. Hence proposals floated from time to time such as those by Houthakker, *supra* note 11, p. 486 to limit margins would defeat the purpose of price discovery: e.g. L.G. Telser, and B.S. Yamey, "Speculation and Margins", *Journal of Political Economy*, Vol. 73, p. 656 (1965).

19 E.g. "'Futures' are contracts for the sale or purchase of commodities for future delivery on a date and at a price fixed at the date of the contract." *E. Bailey & Co. Ltd. v. Balholm Securities Ltd.* [1973] 2 Lloyd's Rep. 404 at p. 405. See also, e.g., *Wilson, Smithett & Cope Ltd. v. Terruzzi* [1975] 1 Lloyd's Rep. 642 at p. 652; *S.C.F. Finance Co. Ltd. v. Masri* [1986] 2 Lloyd's Rep. 367 at p. 369; *Commissioner for Corporate Affairs v. Shintoh Shohin Pty. Ltd.* (1987) ASLR 76-134 at p. 85,310.

20 Parliament of the Commonwealth of Australia, House of Representatives, *Futures Industry Bill 1986, Explanatory Memorandum*, 1986, p. 20.

21 *Ibid.*, p. 18.

22 *Corporations Law* s.72.

with few retail investors does not call for regulation.²³ Four classes of futures contract are caught by the s.72 definition:

1. A deliverable futures contract, referred to in the Corporations Law s.72 as an "eligible commodity agreement". The Corporations Law differentiates a futures contract from a forward contract in part by the fact that delivery under the latter generally does not occur. Hence the definition of an "eligible commodity agreement" is designed to indicate which commodity agreements²⁴ fall within the definition of a futures contract.²⁵
2. "adjustment agreement". The Corporations Law²⁶ defines this form of cash settlement futures contract as a standardised non-deliverable agreement under which a person will pay or receive an amount of money calculated by reference to "a particular state of affairs existing at a particular future time".
3. "futures option". This futures contract is defined in s.9 of the Corporations Law as an option over a futures contract,²⁷ or the option or right to assume at a specified price or value and within a specified time a bought or a sold position in relation to an eligible commodity agreement or an adjustment agreement.
4. a prescribed exchange-traded option. This contract gives the right to buy or sell a futures contract in return for a premium within a stated period at a predetermined price. Exchange-traded options began trading on the SFE in May 1985, and are available on most futures contracts. A prescribed exchange-traded option also includes a commodity option listed on an Australian futures exchange.

²³ *Explanatory Memorandum, supra* note 20, p. 25. With flexibility of regulation in mind, any other agreement prescribed by regulations are also excluded.

²⁴ *Corporations Law* s.9; under a "commodity agreement", physical delivery is possible.

²⁵ E.g. in *Carrageen Currency Corp. v. C.A.C.* (1987) 5 ACLC 148; noted (1987) 5 C. & S.L.J. 264, (1988) 6 C. & S.L.J. 141 (correspondence), the broker's sale of an option to purchase foreign currency was held to be an "eligible commodity agreement". The clients were the takers/buyers of call options. This case showed the difficulty facing the legal profession of coming to terms with this area still new to the law: Hodgson, J. held Carrageen's contracts to be both "eligible commodity agreements" (correct) and "futures options" (incorrect). By definition they must be one or the other. Case law had clarified the definition of "commodity" in the predecessor to Corporations Law s.9 (F.I.C. s.4) ("any thing that is capable of delivery") to include foreign currency and money: *Shoreline Currencies (Aust.) Pty. Ltd. v. CAC (N.S.W.)* (1986) 4 ACLC 686, noted (1987) 5 C. & S.L.J. 122, involving the purchase of foreign currency to be delivered to the client with the price fixed by reference to \$US.

²⁶ *Corporations Law* s.9.

²⁷ *Loc cit.*

Several issues arise from the legislation regulating the futures industry and the extent to which it actually helps to achieve its purpose of fair and orderly markets. Each is considered in turn in the following pages:

1. The impact of competition law on the futures industry.
2. Consumer protection: conduct of business.
3. Broker competence.
4. Fidelity fund.
5. Clearing house.
6. Prohibition of undesirable and fraudulent practices.
7. Enforcement of futures industry law.

III. THE IMPACT OF COMPETITION LAW ON THE FUTURES INDUSTRY

But as Harvard economist Professor Hendrik Houthakker puts it, is not the "pit, with hundreds of traders actively participating in the determination of prices, the very epitome of perfect competition?"²⁸ And if so, shouldn't competitive forces alone be allowed to shape the futures markets? The role of competition is as a mechanism for discovery of market information. Prices and profits are the signal which register the play of the forces of supply and demand,²⁹ and competition between buyers and sellers, in pursuit of self interest, leads to outcomes that could not be improved upon by regulation.³⁰ In a state of competition, no trader can affect the price more than momentarily. However, economist Adam Smith's lesson raised in the 18th century, that perfect competition is not self-sustaining, has frequently been illustrated by industry cartels and anti-competitive practices in exercise of market power. This is especially so with exchanges which as monopolistic institutions are able to restrict and determine membership and self-regulation in their own interests.

The *Trade Practices Act 1974* (Cth.) impacts on the futures industry in two areas. Firstly, Part V, headed "Consumer Protection" in seeking consumer protection for its own sake, and as a stimulus to competition, catches misleading and deceptive conduct and false or misleading representations and is considered in the futures industry context in Part VIII below. Secondly, Part IV, headed "Restrictive Trade Practices" seeks industry efficiency and resulting community benefit, and competition as a means to that end. The Australian legislation is modelled on U.S. anti-trust law and involves dual enforcement both by the

28 Cited at note 11, *supra*, p.481.

29 *Re Queensland Co-operative Milling Association Ltd., Defiance Holdings Ltd.* (1976) ATPR 40-012 at p.17,245 per Trade Practices Tribunal (Justice Woodward, J.A.F Shipton, Prof. M. Brunt).

30 D.R. Fischel, and S.J. Grossman, "Customer Protection in Futures and Securities Markets", *Journal of Futures Markets*, Vol.4, No.3, 273 at p.280 (1984).

Trade Practices Commission, and on appeal the Trade Practices Tribunal and the courts. Certain anti-competitive behaviour can however be "authorized" by the Trade Practices Commission upon proof of benefit to the public, if the benefit outweighs the detriment to the public caused by the lessening of competition.³¹ Hence, the Memorandum, Articles and Rules of the various exchanges have come before the Trade Practices Commission for authorization since the passing of the Act. This process has hastened exchange deregulation or "Big Bang" in the Australian futures and securities markets with the removal of barriers to corporate and foreign owned exchange membership, freeing of charges by brokers and various business activities of brokers.³²

The rules of the Sydney Futures Exchange as set out in its Articles of Association, By-Laws and Trading Etiquette Manual were authorized by the Trade Practices Commission subject to minor alteration as to procedure for appeals.³³ Apart from querying the cost of Sydney Futures Exchange membership, the Trade Practices Commission - confirming the submissions received from related industry associations - saw benefit to the public in the Exchange's business rules in their creation of an efficient market enabling primary producers, processors, borrowers and lenders, importers and exporters to hedge their risks. Public benefit was achieved by criteria which required a high standard of integrity, financial probity, trading expertise and knowledge of the Exchange, and public benefit was held to outweigh any anti-competitive detriment resulting from the business rules.

IV. CONSUMER PROTECTION: CONDUCT OF BUSINESS

An investor in futures contracts has little information available on the contract before or after purchase compared to the substantial information mandated by securities laws for investors in securities.³⁴ A large percentage of Chapter 8 of the Corporations Law ("The Futures Industry") is designed to redress alleged or potential market failure to protect consumer interests by securing improved economic performance.³⁵ It recognises that consumers will be protected when they receive transactions of the highest quality that can be

31 *Trade Practices Act 1974* (Cth.) s.90(7).

32 *Final Determination on Application by Australian Stock Exchanges* (1982) ATPR (Com.) 50-049; (1984) ATPR (Com.) 50-068; 50-075; 50-080; 50-081; (1987) ATPR (Com.) 50-053.

33 Extend to Local Members the right of appeal to an Extraordinary General Meeting; provision of an appeal process to persons nominated by the Board who are independent of the SFE: *Sydney Futures Exchange Ltd.* (1986) ATPR (Com.) 50-115.

34 Such as prospectuses, annual reports, annual general meetings, capped by the "know your client" rule of Corporations Law ss.851 to 853 discussed at text accompanying note 76, *infra*.

35 E.g. A. Fels, "The Political Economy of Regulation" (1982) 5 *UNSWLJ* 29 at 32.

produced at the price they are willing to pay.³⁶ Hence, the main thrust of any consumer protection legislation can be justified on equitable and economic grounds. "Equitable grounds" refers to fairness. Any economic justification rests on the proposition that inadequate levels of consumer protection can lead to loss of confidence in the market and withdrawal of investment. This loss of liquidity may therefore reduce one of the major benefits of futures markets, that of risk transference.

The seven sections comprising Part 8.4 of the Corporations Law (called "Conduct of futures business") lay down minimum levels of consumer protection by legislatively prescribing standards of conduct to provide for standards of disclosure of information to the market and propriety to facilitate informed and efficient decision making. Part 8.4 however makes no allowance for the cost of mandated disclosure.³⁷ It does not allow for an investor to voluntarily purchase a "no frills" product, as it forces minimum levels of disclosure which may not be needed by or wanted by some investors.

The law requires that certain information be provided and that it be honest. A licence holder cannot claim sanction by the ASC,³⁸ and in the public interest the Corporations Law prohibits undesirable advertising.³⁹ A contract note (in the U.S., a confirmation slip) is to be issued to inform the investor of the essential features of the contract such as date, description, deposit paid etc.,⁴⁰ and a monthly account is to be provided to the client to keep the client informed within seven days after the end of the month containing the details specified.⁴¹ The main disclosure called for under the Corporations Law is the Risk Disclosure Statement, a document setting out basic principles of trading in futures contracts.⁴²

36 E.g. Fischel and Grossman, note 30, *supra*, p.273.

37 *Ibid.*, p.282. Is there any evidence to suggest that there is a cost of disclosure? Disclosure may make a more informed market at little or no cost.

38 *Corporations Law* s.1204 parallelling *Corporations Law* s.841 applying to securities business. A false representation as to sponsorship may infringe *Trade Practices Act* 1974 (Cth) ss.53(c) or (d): discussed at text accompanying notes 127 to 128, *infra*.

39 *Corporations Law* s.1205. Predecessor applied, e.g., in *Shoreline Currencies (Aust.) Pty Ltd. v. C.A.C. (N.S.W.)* (1986) 4 ACLC 686, note 25, *supra*.

40 *Corporations Law* s.1206(3), which parallels *Corporations Law* s.842.

41 *Corporations Law* s.1207, a section with no direct parallel in Chapter 7 (Securities); not required in respect of transactions by a futures broker on behalf of a member of a clearing house as the information provided by the clearing house is taken to fulfill the requirements of *Corporations Law* ss.1206 and 1207.

42 *Corporations Law* s.1210(a)(iii). Futures Industry Regulations r.24 prescribes the form in Form 12. The Sydney Futures Exchange has incorporated this statutory form into its more comprehensive "Explanatory Document and Risk Disclosure Statement" appearing as Practice Note 10. Mandated Disclosure statements are not unique to the futures industry.

The Corporations Law confirms the common law duty of any agent to act in the interests of its principal.⁴³ However, a broker is not prohibited from taking the other side of a futures contract, as generally no conflict of interest is possible if trades are done in accordance with Exchange rules and subject to the competitive bidding process.⁴⁴ Taking the other side of a cross executed under the Exchange's rules arguably does not conflict with principal/agent law; nor would a floor trader necessarily know if orders were client orders or house orders.⁴⁵ In contrast, anti-client conduct such as "knowingly" taking the other side of a client order would infringe s.1208(3) of the Corporations Law.⁴⁶ This is added to in s.1266⁴⁷ and the basic rule that futures brokers are to transmit all clients' instructions in sequence of receipt. Records are to be kept as to date and time of receipt, transmission, execution, etc.: Corporations Law s.1266(7).

Also in line with principal/agent principles, money and property of the client is to be segregated when deposited by a client with a licensed broker,⁴⁸ and banked in a "clients' segregated account"⁴⁹ to be held for the purposes of the client.⁵⁰ Records are to be kept, and clients' funds are not available for debts or liabilities of a broker.⁵¹

For example, the *Insurance Contracts Act* 1984 (Cth) s.22 requires an insurer to clearly inform the insured in writing in the prescribed form of the duty of disclosure.

- 43 "The relationship has fiduciary aspects relating to moneys and securities held by the broker, but otherwise the broker's duty is to execute orders": *Option Investments (Aust.) Pty Ltd v. Martin* [1981] V.R. 138 at p.142; (1980-1984) ASLR 76-004 at p.86,154. The broker/client relationship may be fiduciary: "A fiduciary relationship can arise and fiduciary duties can exist between parties who have not reached, and who may never reach, agreement upon the consensual terms which are to govern the arrangement between them": *United Dominions Corporation Ltd. v. Brian Pty. Ltd.* (1985) 157 CLR 1; M.G. Hains, "Duties and Obligations of a Futures Broker to His [sic] Client" (1987) 3 *Aust. Bar. Rev.* 122, esp. at p.143 ("there is no doubt that a Broker is a fiduciary vis-a-vis his client.")
- 44 As confirmed in Sydney Futures Exchange, Practice Note 3 (Taking other side of client order). However, the system could be open to abuse, although conflict is unlikely to arise if the rules are followed.
- 45 Sydney Futures Exchange, Practice Note 3 (Taking other side of client order): therefore within the consent requirements of *Corporations Law* s.1208(3)?
- 46 Parallels *Corporations Law* s.843; an offence under *Corporations Law* ss.1258 and 1264 discussed at text accompanying notes 100 to 102, *infra*.
- 47 *Corporations Law* s.1266; cf. *Corporations Law* s.844 (securities).
- 48 *Corporations Law* s.1209(3).
- 49 *Corporations Law* s.1209(4); Sydney Futures Exchange Art. 43, worked examples given in Sydney Futures Exchange Practice Note 12.
- 50 *Corporations Law* s.1209(5) and (6). For the purpose of *Corporations Law* s.1209 (5)(d), authorised trustee investments in various government and blue-chip securities are detailed in Practice Note 4 of the Sydney Futures Exchange.
- 51 *Corporations Law* s.1209(14).

V. BROKER COMPETENCE

Licensing of financial intermediaries to require specified standards of education, experience and financial competence goes back at least to the pioneering Kansas Act of 1911⁵² on the basis that the service provided cannot be fully judged at the time of its consumption and that failure in the service has the potential to cause serious financial harm. However, licensing raises the question of how to maintain balance between the efficiency and integrity of the futures market and the legislative interference with freedom of trade, creating industry self-interest and barriers to entry. The former National Companies and Securities Commission's Licensing Green Paper of 1985 examined these issues, and ultimately decided in favour of transferring the bulk of licensing administration to the industry's self-regulatory organisations in the interests of flexibility and informed decision making subject however to the overriding surveillance of the NCSC acting in the public interest.⁵³

With the express goals of efficiency, honesty and fairness,⁵⁴ the Corporations Law provides for national licensing of principals (brokers and advisers) on a co-regulatory model⁵⁵ and seeks to satisfy judicial criticism on the previous paucity of consumer protection safeguards.⁵⁶ Licensing of futures brokers and

52 Kan.L. 1911, c.133, discussed in L. Loss, *Securities Regulation*, Boston, Little, Brown and Company, 1961, pp 27-28; Fischel and Grossman, *supra* note 30, p.275. Licensing in the U.K. of those dealing in investments goes back at least to the suggestions of the Greene Committee on Company Law in 1926: Cmnd. 2657, para. 92.

53 National Companies and Securities Commission, *A Review of the Licensing Provisions of the Securities Industry Act and Codes*, Canberra, A.G.P.S., 1985 (recommendations largely in force from 1 November 1989 by *Co-operative Scheme Legislation Amendment Act 1989* (Cth); discussed in P. Latimer, "Regulation of Securities Industry Intermediaries - Australian Proposals", *University of Pennsylvania Journal of International Business Law*, Vol.9, No.1, p.1 (1987).

54 *Corporations Law* s. 1145(2)(f).

55 The *Corporations Law* (and its predecessor, the F.I.C.) supercede the earlier scheme under the *Futures Markets Act 1979* (N.S.W.) which had provided approval of a body corporate as a futures exchange if, inter alia, its business rules made provision for membership qualifications and surveillance.

56 In *Bargold v. Wesson Walshe Pty Ltd* (*Supreme Court of N.S.W.*, 16 November, 1981, unreported, noted in Walker, *supra*, note 3, p.25), Rogers, J. noted:

"the attention of the authorities should be [drawn to] a state of affairs where dealings in substantial amounts, take place in precious metals without any of the safeguards which are afforded to persons trading ... on the Sydney Futures Exchange ... there is no system of licensing in respect of entities such as Bargold ... and the evidence [reveals] a lack of

futures advisers⁵⁷ under the Corporations Law⁵⁸ is the responsibility of the ASC and the industry.⁵⁹ Legislative amendments in force from 1 November 1989 confirm the legal responsibility⁶⁰ of futures brokers and futures advisers for the conduct of their representatives⁶¹ while the representative holds the principal's "proper authority".⁶² The ASC's predecessor, the NCSC had always imposed conditions on brokers and advisers requiring training, supervision, compliance with legislation and rules, and maintaining a register of licensees.⁶³ The previous sections on the licensing of brokers' and advisers' representatives were never proclaimed⁶⁴ but in the case of the Sydney Futures Exchange, they pre-dated the Corporations Law as SFE article 37.⁶⁵ Representatives are to be registered with the Exchange and to have passed the Exchange's examination.⁶⁶

Public information on brokers and advisers is available from the ASC's Register of Licence Holders.⁶⁷ In turn, licensees are to keep a register of holders of proper authorities⁶⁸ (available to the ASC and the public)⁶⁹ containing details of authorities and identification of representatives.

complete understanding by those engaged in this market in relation to the transactions into which they have entered."

- 57 *Corporations Law* ss.1142 and 1143 respectively. A futures adviser carries on "Futures advice business" as defined in *Corporations Law* s.71.
- 58 *Corporations Law* ss.1144A-1145.
- 59 Through the definition in *Corporations Law* s.9 of a "futures organisation": "a futures association" i.e. the SFE or the AFFM. Under *Corporations Law* s.1148, a futures broker's licence is subject inter alia to a condition that the licensee be a member of a futures organisation.
- 60 *Co-operative Scheme Legislation Amendment Act 1989* (Cth) Part IV, Div.4 (Liability of principals for representatives' conduct); replaced by *Corporations Law* on 1 January 1991, Part 8.3, Division 4.
- 61 As defined in *Corporations Law* s.73.
- 62 As defined in *Corporations Law* s.87.
- 63 Now clarified in *Corporations Law* s.1147, allowing the imposition of conditions or restrictions in a futures broker's licence.
- 64 Former F.I.C. former ss.62 and 64, repealed by *Co-operative Scheme Legislation Amendment Act 1989* (Cth) s.71; not included in the *Corporations Law*.
- 65 Article 37 pre-dates the *Corporations Law*: its existence has meant that there has been no gap because of non-proclamation.
- 66 Educational and experience guidelines have been released by the former NCSC (NCSC Release 333) and by the SFE (Sydney Futures Exchange, Practice Note No.7) [Educational and experience requirements for futures brokers and futures advisers licences].
- 67 *Corporations Law* s.1155.
- 68 *Corporations Law* s.1176.
- 69 Under *Corporations Law* ss.1177 and 1178 respectively.

The Corporations Law gives the regulators and the self-regulators extensive power to ensure the efficient, honest and fair operation of these provisions,⁷⁰ and the shared responsibility achieves the economies advocated by the ASC's predecessor, the NCSC in its Licensing Green Paper.⁷¹ Licensees' conduct is monitored by the ASC in conjunction with the SFE, the Immigration Department, the National Crime Authority and the Federal Police. Since the former F.I.C. came into operation, a large number of investigations have been undertaken into the conduct of some futures brokers and leveraged currency dealers (mostly not members of the SFE), leading to action ranging from refusal of a licence, suspension of licences and fines to criminal charges.⁷² The Corporations Law gives the ASC clear power to exclude persons from the futures industry by revoking a licence,⁷³ suspending a licence⁷⁴ and the ultimate sanction directed against a person whose licence is revoked or suspended, and a representative, the banning order for permanent prohibition from the industry.⁷⁵

Australian securities industry law has adopted the U.S. "know your client" rule which requires a securities industry broker to recommend to its client only those securities which are suitable to the client's needs in view of the client's financial resources and investment purpose.⁷⁶ Such requirement does not exist in Australian or U.S. futures industry law, though it has been incorporated in the U.S. by anti-fraud case law.⁷⁷ Such requirement would be impracticable, as it would require SFE members to assess the creditworthiness of clients. The absence of such requirement in the Corporations Law could equally be compensated by the right to sue under the *Trade Practices Act 1974* (Cth) and under common law principles.⁷⁸

70 E.g. a false or misleading statement made in a licence application constitutes a penal offence: *Corporations Law* s.1308.

71 Note 53, *supra*.

72 NCSC, *Annual Report 1986-1987*, *supra* note 15, p. 43; NCSC, *Annual Report 1987-1988*, *supra* note 15, p.45.

73 *Corporations Law* s.1190.

74 *Corporations Law* s.1192.

75 *Corporations Law* s.1194.

76 *Corporations Law* ss.851 to 853. See, e.g. J. Pascoe, "Section 65A of the Securities Industry (Victoria) Code" (1988) 62 *LJ* 736; cf. S. Scherer, "The Stockbrokers' Duty of Care in the US and UK (2) - Establishing a Suitability Doctrine" (1985) 6 *The Company Lawyer* 164; NYSE Rule 405.

77 E.g. *Gordon v. Shearson Hayden Stone, Inc.* Comm. Fut. L. Rep (CCH) 21,016 (1982), noted Fischel and Grossman, note 30, *supra*, p.276. The CFTC has repeatedly held that there is no general "know your client" rule in the U.S. Of course, it exists in Australian law as negligence, and misleading or deceptive conduct under *Trade Practices Act 1974* (Cth.) s.52.

78 See Part IX, *infra*.

VI. FIDELITY FUND

Unlike the purchase of most goods and services, the purchase of a futures contract (like the purchase of a security) represents entering an ongoing contractual obligation. A futures contract must be distinguished from a security such as a share which gives a proprietary right in a company which exists independently of the agreement to buy or to sell; it is a creation of the market itself. If the purchase of the futures contract fails to materialise, the investor must turn to the broker for recompense. If for any reason the broker is unable to provide compensation, the investor may be left without legal remedy.

Hence several areas of law require the creation and maintenance of a fidelity fund to ensure "faithfulness" in performance of legal obligations.⁷⁹ The Corporations Law requires such a fund from a futures exchange and a futures organisation to provide compensation to any person suffering pecuniary loss because of defalcation or because of fraudulent misuse of money or property by a contributing member of the fund.⁸⁰ The fund set up by the SFE holds the initial contribution or "basic amount" of \$500,000 from the Exchange,⁸¹ and is built up by a basic levy of 10 cents per trade.⁸²

It is not certain how useful any fund would prove in a major downturn in the market. The fund may not cover a single default or insolvency in the absence of the exercise of the Board's discretion, but it would cover the situation where a broker failed to enter futures contracts on behalf of the client and stole or "bucketed" the client's funds (as "defalcation" or "fraudulent misuse" per s.1239).⁸³

The equivalent provisions in the predecessor of Corporations Law Chapter 7 (Securities)⁸⁴ were found very limited (despite the court's wide interpretation) in *Daly's case*,⁸⁵ a case holding that an amount of \$30,000 lodged by investors with a broker not in connection with trading in securities but as an unsecured term deposit was, after eleven years before the courts, irrecoverable on the

79 Such as the National Guarantee Fund established under *Corporations Law* Part 7.10.

80 *Corporations Law* s.1239.

81 No amount specified in *Corporations Law* s.1229.

82 Per *Corporations Law* s.1229(1)(c)), imposed by S.F.E. Art.44, added 29 May, 1986; detailed in Sydney Futures Exchange Practice Note No.14 (Contributions to fidelity fund). This is a small amount compared to the value of some futures contracts. Recognising that one default may lead to others, a levy in addition to annual contributions can be imposed under *Corporations Law* s.1235. When one futures broker went into voluntary liquidation in 1983, unsecured creditors were owed \$691,000: Walker, *supra* note 3, p.25. The fund currently stands at several times its minimum amount.

83 *Corporations Law* s.1239.

84 *Corporations Law* s.907, evolved from *Securities Industry Act* 1970 (N.S.W.) s.58(1)(b).

85 *Daly v. Sydney Stock Exchange Ltd.* (1986) 60 A.L.J.R. 371, discussed (1987) 61 ALJ 241. Gibbs CJ stated obiter at p.374 that the term defalcation may include negligence.

grounds that failure to account did not amount to defalcation. No constructive trust was able to be imposed by the court to prevent unjust enrichment by the broker, and it was held that the broker, as a creditor of the investors, could not be treated as trustee. These provisions have now been augmented by the creation of the securities industry's National Guarantee Fund,⁸⁶ but the question of the adequacy of fidelity fund provisions must be addressed. In any case, the safeguard against the collapse of a futures market is the clearing house.

VII. CLEARING HOUSE

Maintaining the credibility and the solvency of the clearing house is an important object of futures industry regulation. The clearing house is the agency responsible for the administration, recording, fulfilment and guarantee of futures contracts as it settles mutual indebtedness between parties. It enables the trading by price alone of contracts standardised as to quality on common ground, thereby marking the distinction with a forward contract.⁸⁷ Futures markets operate on a "no debt" basis⁸⁸ through the clearing house's deposit and margin system. When a futures position is opened, a deposit (performance bond) is paid to the clearing house calculated on its perceived exposure. By daily payment of margin debits to the clearing house calculated by comparing current market values with original contract values, buyers and sellers progressively pay their debit amounts effectively maintaining current market values. Exchange participants are therefore fully paid up or "marked to the market" for that day. The clearing house holds all members personally liable on futures contracts.⁸⁹ This collection of margins on a daily basis remains the

86 Under *Corporations Law* Part 7.10. In contrast, the U.S. Commodities Exchange Act establishes the Securities Investor Protection Corporation, a non-profit corporation created by Congress, funded by members to provide financial protection to clients of failing brokerages: *Commodity Exchange Act* 1922 (U.S.), 7 U.S.C.A. s.6d(2).

87 A forward contract is a contract between parties to buy or sell a physical commodity at a point of time in the future to hedge price risk. Its terms are confidential to the parties, and delivery of the commodity is intended to occur. No institutionalised market structure like a futures exchange interposed between parties exists to enable trading of forward contracts or offset to remove the possibility of making or taking delivery: e.g. Sydney Futures Exchange Ltd., *Futures Trading Course*, 1987, p.53-54.

88 C.G. Veljanovski, *An institutional analysis of futures contracting*, in Goss, *supra* note 17, p.24. See further Sydney Futures Exchange, *Futures Trading Course*, 1987, *supra* note 87, pp.55-59; R. Bruce, B. McKern, I. Pollard, M. Skully, *Handbook of Australian Corporate Finance*, Butterworths, 3rd ed. 1989, par.17.01 ff.

89 M. Markovic, "The Legal Status of Futures Market Participants in Australia" (1989) 7 *C. & S.L.J.* 82 at p.86.

foundation of the financial security of the market, as all outstanding paper losses are paid by members.

Contract default by contract participants is removed by the interposition of the clearing house between buyer and seller.⁹⁰ With its system of deposits and margins, the clearing house can guarantee the performance of the contract participants.⁹¹ This guarantee - and the basic concept of a futures contract - ensures equality in the number of bought and sold contracts when the contract ceases trading. It also ensures that buyers and sellers will be able to perform their contractual obligations. But who will guarantee the clearing house, its fulfilment of open contracts, its solvency,⁹² its ability to collect margin deposits from its members and its membership requirements?

Clearing house co-regulation involves approval by the Minister as a body corporate that proposes to provide clearing house facilities for a futures market of a futures exchange, and once approved,⁹³ clearing house self-regulation. For approval by the Minister, the clearing house must establish its credibility through evidence of satisfactory business rules (especially those relating to the registration of futures contracts),⁹⁴ satisfactory provision for supervision of its members and serving the interests of the public.⁹⁵ Once approved, a clearing house is under a statutory obligation to do all things necessary to ensure an orderly and fair market for dealings in futures contracts, actionable under Corporations Law s.1324 on the application of the ASC or any person affected if successful by the award of an injunction and/or damages. Co-regulation is ongoing, and the Corporation Law provides that the Minister shall receive notice of, and have the power to disallow, any amendments to clearing house

90 By novation, and arguably, by two novations (novation is the procedure of substituting one party to a futures contract for another, facilitating the process of closing out): the first on contract registration, when the legal nexus between the original seller and buyer is broken and the clearing house becomes the buyer to the original seller, and the second between the original buyer and the clearing house as seller: Markovic, *supra* note 89, p.89.

91 The terms of the ICCH guarantee are set out in Markovic, *supra* note 89, p.85n.

92 E.g. Houthakker, *supra* note 11, p.489. Brokers defaulting on Hang Seng Index futures contracts in Hong Kong owed the Hong Kong Guarantee Corporation \$HK1.8 billion; in 1974, the French clearing organisation (CLAM) failed to meet its obligations: Markovic, *supra* note 89, p.95.

93 *Corporations Law* ss.1128-1131 (approval by the ASC).

94 In 1989-1990, the SFE introduced another new contract. This involved consultation with the then NCSC in the development of the contract, examination in detail of its rules, and ongoing monitoring: NCSC *Annual Report* 1989-1990, *supra* note 15, p.48. The entry barriers facing U.S. exchanges are vigorously criticised by D.R. Fischel, "Regulatory Conflict and Entry Regulation of New Futures Contracts", *Journal of Business*, Vol. 59, Supplement, S85 (1986).

95 *Corporations Law* s.1131(2).

business rules or constituent documents.⁹⁶ Co-regulation would tend to confirm that the clearing house rules would in fact guarantee fulfilment of open contracts, and the solvency of the clearing house.

The SFE contracted in 1969⁹⁷ with the London-based International Commodities Clearing House (hereafter ICCH)⁹⁸ for the clearing of futures contracts. Contracts traded on the SFE are registered with ICCH,⁹⁹ and the financial security of the market and the contractual obligation of participants is maintained by its daily deposit and margin calls. The "Regulations for Future Delivery Business" govern dealings between ICCH and its clearing members. By a formula ICCH calculates and publishes a closing call price based on price quotations which is used to estimate market price fluctuations and a deposit rate. This rate is applied to a member's exposed open contracts to determine deposit liabilities. Margin liabilities are calculated by ICCH by comparing the closing call price and the futures contract price. Therefore the contracts traded on the futures exchange (registered by ICCH) and each participant's contractual obligation is maintained by this system of deposits and margins. Regulations of ICCH contained in the "Regulations for Future Delivery Business" preserve the integrity of the market by providing procedures for the acceptance of contracts for registration for a clearing member. ICCH's role of contract registration and contract guarantee as supervised by the Minister and the ASC thereby provides some client protection against member default.

96 *Corporations Law* s.1136. In 1989-1990, no notices of amendment to clearing house Business Rules were lodged (compared to one for the Australian Financial Futures Market and fifteen for the SFE): NCSC *Annual Report* 1989-1990, p.49.

97 The SFE has announced that it intends to establish its own clearing house, and it is expected that regulatory approvals will be sought in 1990-1991: NCSC *Annual Report* 1989-1990, p.48.

98 Dating from 1888, the I.C.C.H. was originally formed by a group of merchant bankers and commodity merchants in London as the London Produce Clearing House for clearing and guaranteeing futures contracts. In 1950 it was sold to United Dominions Trust, and is currently owned by a consortium of five London clearing banks. The ICCH also provides clearing for futures markets in London, Paris, Hong Kong, Kuala Lumpur, Singapore, New Zealand, Bermuda, Montreal and the Baltic Exchange: Giuffre, *supra* note 1, p.172; C. Rock, "Regulatory Control Over the United States, Canadian and United Kingdom Futures Markets", 37 *The Business Lawyer* 613 at p.617 (1982). In 1989, the clearing division of ICCH was separated under the name LCH (London Clearing House) from ICCH's data processing, information technology and other activities.

99 The record of registration of contracts of each clearing member is said to be "totally confidential between the member and the clearing house": SFE, *Futures Trading Course*, 1987, *supra* note 87, p.62. In fact, all constituent documents must be approved (i.e. not disallowed) by the ASC under *Corporations Law* s.1136. The ASC's powers of investigation under the ASC Law appear to have few limits.

VIII. PROHIBITION OF UNDESIRABLE AND FRAUDULENT PRACTICES

There can be no objection to provisions designed to deter undesirable and fraudulent practices. In addition to the on-going disclosure requirements outlined above, Part 8.7 of the Corporations Law enumerates specific offences largely in parallel with those well established and understood under the former *Securities Industry Act* 1980 (Cth) and State Codes (S.I.C.) (now Part 7.11 of the Corporations Law). They are enforced by criminal penalties (by the ASC: ss.1311-1312) and by civil damages (by a person so affected: s.1265).

Of unique importance is Corporations Law s.1258 and its encouragement of on-floor futures trading designed to overcome some of the problems previously encountered by the futures industry which were found to be caused by non-members of the SFE engaged in off-market trading.¹⁰⁰ Off-floor trading has the potential for abuse such as bucketing,¹⁰¹ and loses the back-up of the exchange's fidelity fund, the guarantee protection of the clearing house and the professional competence and prudential requirements brought about by co-regulation.¹⁰²

The remaining sections of Part 8.7, Division 2 of the Corporations Law directly parallel those in Chapter 7 regulating the securities industry. Insider

100 As in the U.S., where under the *Commodity Exchange Act*, certain transactions must occur on the Exchange. A futures exchange must be approved by the Minister under ss.1123-1127 (see text accompanying note 13, *supra*). Only specially exempted leveraged operations which fall outside the definition of a "futures contract" in *supra* note 19 *et seq.* are permitted to occur outside a registered Exchange.

101 Also caught by *Corporations Law* s.1264. Orders not placed for execution on the exchange are denied clearing house contract guarantee. Section 1258 is important because the broker may take the other side of the transaction, or match it with equal and opposite orders from other clients at prices not determined competitively: *Futures Industry Bill 1986*, Explanatory Memorandum, p.117; D.A. Chaikin, "Commodity Investment Fraud", (1985) 6 *The Company Lawyer* 261 at p.266; M.G. Hains, *Bucketshop busters*, paper delivered at Seminar on Policing Corporate Crime, Institute of Criminology, Sydney University Law School, 16 September 1987.

102 Off-floor trading is only permitted if allowed by exchange rules, as authorised under *Corporations Law* ss.1126(2)(xiii), 1132(2)(xii). The former NCSC and its delegates had actively suppressed off exchange contracts, such as doubtful "dealer option" and "leverage" contracts (between person and person, not with the clearing house): e.g. *Corporate Affairs Commission v. Shintosh Shohin Pty. Ltd.* (1987) ASLR 76-134 (Shintosh always purported to deal on recognised Japanese futures exchanges, but in fact it did not); *Corporate Affairs Commission v. Lombard Nash International Pty. Ltd.* (1987) 5 ACLC 269; (No.2) (1988) 5 ACLC 651, (1987) 9 NSWLR 497; (No.3) (1988) 5 ACLC 1,020. (dealer/customer, effectively on the dealer's own futures exchange). Lombard did not purport to trade on markets, and went to some length to make clear that it did not trade futures contracts).

trading is prohibited for its undermining of the viability of any market for information and its conflict with basic ethical rules of commercial morality.¹⁰³ But the prohibition must be balanced with the incentive to research.¹⁰⁴ Without market analysis etc., leading to a superior return to those not engaging in research, the role of the futures market in aggregating information would break down.¹⁰⁵

Several sections deal with manipulation of the market, information, or investment decisions. Trading to create an artificial price is prohibited under Corporations Law s.1259, such as manipulation of futures contract prices by "squeezing" and "cornering" to ramp the market by manipulation of supply and demand of the actual or the underlying physical commodity.¹⁰⁶ Manipulation refers to the exploitation of a distortion in the price of a commodity;¹⁰⁷ as understood in securities industry law it "connotes intentional or wilful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"¹⁰⁸ whether by regularising a declining market, stabilising the market (especially in a new issue), pushing up or pushing down the price as the case may be.¹⁰⁹ False trading or market rigging is proscribed under Corporations Law s.1260¹¹⁰ on the grounds that the market should reflect only genuine arm's length transactions which have resulted from the free play of the forces of supply and demand.¹¹¹ Activities so caught include churning,¹¹² wash sales, matching orders, pools and other tactics disadvantaging the client.

103 *Corporations Law* ss.1251 to 1257.

104 Fischel and Grossman, *supra* note 30, pp.289-290.

105 But no law should reward insider profits even if called management incentives. The iconoclastic contrary view in defence of insider trading espoused by commentators like Henry G. Manne, "In Defense of Insider Trading", 44 *Harvard Business Review* 113 (1966), answered appropriately by R.A. Schotland, "Unsafe at any Price: a Reply to Manne", 53 *Virginia Law Review* 1425 (1967), has not been accepted.

106 E.g. a buyer could accumulate a large holding of contracts of a particular maturity date, and at the same time gain control of the major part of the physical commodity. The buyer could then demand delivery and squeeze the sellers of the futures contracts as the delivery date approached: NCSC Media Release 88/68, "Sydney Futures Exchange September 1988 Ten Year Bond Contract"; the Hunt Brothers and the silver market: S. Fay, *The Great Silver Bubble*, London, Hodder and Stoughton, 1982.

107 E.g. E.T. McDermott, "Defining Manipulation in Commodity Futures Trading: the Futures Squeeze" 74 *Northwestern ULR* 202 (1979); Chaikin, *supra* note 101, p.267.

108 *Ernst & Ernst v. Hochfelder* 425 U.S. 185 at p.199; 47 L.Ed. 2d 668 at p.680 (1976).

109 Going back at least as far as *R. v. De Berenger* (1814) 3 M. & S. 67; 105 E.R. 536; cf. *Corporations Law* s.997.

110 Cf. *Corporations Law* s.998 (securities).

111 This law is based on the *Securities Exchange Act* 1934 (U.S.), s.9(a)(2), a section considered to be at the very heart of the U.S. Act.

Another section designed to maintain honesty in the market for information is s.1261,¹¹³ a section rendering it an offence for a person to make a false or misleading statement or to disseminate information that is likely to induce dealing in futures contracts or affect their market price. The section is addressed widely and targets information rather than people. Hence it could readily catch a financial journalist or adviser purveying information acting knowingly or even negligently.

Fraudulently inducing persons to deal in futures contracts by making a statement (recklessly or otherwise) that the person knows to be misleading, false or deceptive, by dishonestly concealing material facts or by recording or storing information that the person knows to be false in a material particular is proscribed under s.1262.¹¹⁴ An example of s.1262 conduct would include a fraudulent representation that a particular futures contract would be traded on a particular exchange when in fact it is instead to be bucketed, matched or crossed in the broker's office instead of being offered to the market competitively.

Disseminating information to the effect that the price for dealing in futures contracts is likely to rise or fall or be maintained because of transactions that contravene the prohibitions set out in ss.1259-1262 (discussed above) is an offence in itself under s.1263.¹¹⁵

The Code also contains a general anti-fraud provision in s.1264 based on U.S. law¹¹⁶ making it unlawful for a futures broker (or any of its agents or employees) to deceive or defraud a client. Action for churning could also be brought under s.1264 for the broker's representation to the client that the level of trading in the account is not excessive.¹¹⁷

In its 1987-1988 Annual Report, the former NCSC noted that the extent of fraud in the futures industry appeared to have declined, and that investigations conducted during the year were generally into conduct which had occurred before the advent of the now superceded F.I.C. and its policing and enforcement.¹¹⁸

112 In futures markets, churning has a particular meaning of excessive trading to gain commissions rather than referring to market manipulation: e.g. Chaikin, *supra* note 101, p.265; M.G. Hains, "Churning and Burning: a Futures Cause of Action?" (1989) 63 *ALJ* 608.

113 Cf. *Corporations Law* s.999 (securities).

114 Cf. *Corporations Law* s.1000 (securities): e.g. *Zweig v. Hearst Corporation* 594 F. 2d 1261 (1979).

115 Cf. *Corporations Law* s.1001 (securities), based on *Securities Exchange Act* 1934 (U.S.) s.9(a)(3) and (5).

116 *Commodity Exchange Act* 1922 (U.S.) s.6b.

117 Hains, *supra* note 112, p. 608.

118 N.C.S.C., *Annual Report*, 1987-1988, *supra* note 15, p. 45.

IX. ENFORCEMENT OF FUTURES INDUSTRY LAW

A false market can be established by conduct varying from the misleading and deceptive to manipulation and fraud. Walker presented an account of the excesses of the pre-regulation period, and along with the industry itself concluded with a call for what has now eventuated, namely a proactive co-regulatory stance with in-depth hands-on knowledge by the co-regulators.¹¹⁹

Enforcement of laws regulating the futures industry in Australia ultimately rests with the ASC.¹²⁰ Because the laws are administered co-operatively,¹²¹ the futures exchanges and futures organisations also have a significant co-enforcement role. Co-regulation also involves the Immigration Department, the National Crime Authority and the Federal Police. The powers of the ASC are wide, and include the power to inspect/investigate, hold hearings (in public or private), intervene in the market (prohibit trading,¹²² intervene in legal proceedings, require assistance from a futures exchange or futures organisation), and license and de-license. The ASC has broad discretionary powers in line with its objects and jurisdiction.

The power of a government or a government agency to regulate is often not in itself an end to the purpose of regulation. Governments sometimes have a poor record of enforcement of their regulatory powers,¹²³ and partly in response to this, standing has been widened beyond government alone. Australian securities industry and futures industry laws give certain enforcement powers to the industry¹²⁴ where a person has contravened business rules to apply to the court for various enumerated orders. This means of co-regulation had proved very effective under the equivalent sections of the S.I.C.

The second statutory means of enforcement of futures industry laws is that under the *Trade Practices Act 1974* (Cth.). Section 52, drafted in wide terms to

119 Notes 2-3 *supra*.

120 Prior to 1 January 1991, the NCSC and its delegates, the Corporate Affairs Commissions of each State and Territory.

121 I.e. primarily by the ASC, but also by futures exchanges and futures organisations.

122 There was no equivalent power to call a trading halt under the now superceded Securities Industry Code: NCSC Crash Report, October 1987, reproduced in CCH *Australian Securities Law Reporter* 70-616.

123 Especially where "captured" by the target of the regulation: on the "capture theory" see, e.g. G.J. Stigler, "Theory of economic regulation", *The Bell Journal of Economics and Management Science*, Vol.2, No.1, p.3 (Spring 1971); G.W. Schwert, "Public regulation of national securities exchanges: a test of the capture hypothesis", *The Bell Journal of Economics and Management Science*, Vol.8, No.1, p.128 (Spring 1977). However, an active self-regulator can often bring things to light which may be unknown to a government regulator.

124 I.e. a futures exchange, clearing house or futures association under *Corporations Law* ss.1268, 1140 respectively; cf. *Corporations Law* ss.1114, 777 respectively (securities).

proscribe conduct that is "misleading or deceptive or is likely to mislead or deceive", is a private law section enforceable between person and person. Case law to date in the securities law area shows s.52 covering similar problems to the equally wide-ranging Rule 10b-5 of the U.S. *Securities Act* 1933.¹²⁵ It has already been used against those in the futures industry.¹²⁶ In contrast, s.53 of the *Trade Practices Act* 1974 (Cth.) is a penal provision enforceable through the Trade Practices Commission rendering actionable false or misleading representations of various kinds. Again, several cases have been brought in the securities industry area¹²⁷ and to date at least one case involving a futures broker.¹²⁸

Always in the background is the possibility of negligence by a professional person. In the *Ace Shohin Case*,¹²⁹ an investor was successful against its futures broker for compensation for losses incurred on margin calls on its futures account. The investor had been originally cold-called,¹³⁰ and ultimately persuaded to invest \$48,000 in red bean commodities futures on the Tokyo Commodity Futures Exchange. Because the broker had in effect guaranteed that there would be no "hidden costs" associated with the investment, and for its failure to disclose the existence and effect of margin calls, the broker was held accountable to the client in negligence for the losses incurred.

125 E.g. *Milner v. Delita Pty. Ltd.* (1986) ATPR 40-669 (Guava Scheme); *Industrial Equity Ltd. v. North Broken Hill Holdings Ltd.* (1986) ATPR 40-682; *Austrasin Pty. Ltd. v. Stratlock Ltd.* (1986) ATPR 40-695; *Bell Resources Ltd. v. The Broken Hill Proprietary Company Ltd.* (1986) ATPR 40-702; *sWheeler, Grace & Pierucci Pty. Ltd. v. Wright* (1989) ATPR 40-940; *Bishop v. Bridgelands Securities Ltd.* (1990) ATPR 41-060; *Springfield Nominees Pty. Ltd. v. Bridgeland Securities* (1991) ATPR 41-078. See further Justice R.S. French, "A Lawyer's Guide to Misleading or Deceptive Conduct" (1989) 63 *ALJ* 250.

126 *Khalaf Aqaiby v. Darlington Commodities Ltd.* (1985) ATPR 40-535 (unsuccessfully); *Dennison v. Ace Shohin (Aust.) Pty. Ltd.* (1987) ATPR 40-793.

127 E.g. *Adams v. Anthony Bryant & Co. Pty. Ltd.* (1987) ATPR 40-784.

128 *Dillon v. Chin* (1988) ATPR 40-899 (s.53(c): Tokyo red beans). Penalty of \$170,000 imposed in December 1988.

129 *Rest-Ezi Furniture Pty. Ltd. v. Ace Shohin (Aust.) Pty. Ltd.* (1987) 5 *ACL* 10, noted (1987) 61 *ALJ* 192.

130 An application for a futures broker's licence by a new company set up by this person and another former Ace Shohin employee was refused on the grounds that it was doubtful if the applicant would be able to perform "efficiently, honestly and fairly" under the predecessor of *Corporations Law* s.1145(2)(f): *Nam Bee (Australia) Pty. Ltd. v. C.A.C.* (1987) *ASLR* 76-136.

X. CONCLUSION

The Australian futures market industry regulation seeks to avoid the heavy-handed and often ineffectual model of industry legislation by allowing the market to operate in a fair and orderly manner. It seeks to overcome the capture model of industry self-regulation with its scheme of co-regulation between market participants and the ASC. Time will tell in the form of the health of the futures industry, its participants and its investors whether futures markets regulation in Australia has achieved its objective.