IN THE BOARD OF APPEAL CONSTITUTED IN TERMS OF SECTION 26 OF ACT 97 OF 1990

In the appeal between

MICHAEL BERMAN Appellant

and

THE FINANCIAL SERVICES BOARD Respondent

DECISION

This is an appeal against the administrative penalty of R2m imposed on appellant by the Enforcement Committee established in terms of section 97 of the Securities Services Act, No. 36 of 2004 (the Act).

Appellant is a director of a company called Velocity Trading (Pty) Ltd. (Velocity Trading). He was also the chief executive officer and the key individual of Velocity Trading which was a financial services provider duly registered as such in terms of the Financial Advisory and Intermediary Services Act, No. 37 of 2002 (the FAIS Act).

Velocity Trading is a hedge fund management company that managed two funds. The first was the Velocity Capital Real Estate Hedge Fund (Velocity Capital), a global macro and real estate hedge fund trading in local and international markets. This fund was managed by Velocity Trading from 1 October 2004. The second was a real estate

hedge fund called the Mayibentsha Fund the ultimate beneficiary of which was an insurance company called Channel Life Limited. The Mayibentsha Fund was managed by Velocity Trading since 10 February 2005. In terms of a management agreement Velocity Capital paid Velocity Trading a management fee and a performance fee both of which were based on the performance of the Fund's investments. To establish the value of the securities of the Fund the reference or closing price of such securities on the day of the valuation was used. The growth of a fund was usually measured at quarter end, i.e. at the end of March, June, September and December. In the case of the Mayibentsha Fund Velocity Trading likewise earned management and performance fees based on the valuation of funds under management.

On 31 March 2005 at 16.20 appellant instructed one Neil Stacey (Stacey), a registered securities trader at HSBC Securities to purchase 4000 Ifour Properties Limited (Ifour) shares on the Johannesburg Securities Exchange (the JSE) at 940 cents per share (cps). At 16:31:06 Stacey entered the bid into the market. At that stage the last recorded transaction in Ifour shares had taken place at 870 cps. By placing a bid to buy 4000 Ifour shares, appellant purchased all the shares on offer at 870 cps and 885 cps and in addition he purchased 212 shares at 940 cps. The new recorded price of Ifour shares thus moved to 940 cps. The increase was, however, short-lived. At 16:31:40 another dealer entered an offer to sell 88 Ifour shares at 840 cps. There was at that stage already a bid in the market to buy 1000 Ifor shares at 840 cps. The bid and the offer accordingly matched and brought the last trading price of Ifour shares back to 840 cps. At 16:41:53 appellant had a further short telephone conversation with Stacey with regard to the movement of the Ifour shares as result of

which appellant decided to wait until closer to the end of the trading day, i.e. 17.00, before issuing a further instruction to Stacey. At 16:57:59, i.e. approximately two minutes before the close of the market, Stacey, on the instruction of appellant, entered a bid to buy 100 Ifour shares at 940 cps. This bid matched an offer to sell 19 721 Ifour shares at 940. The trading price was thereby increased to 940 cps which was the price at which Ifour shares closed on 31 March 2005.

On the same day, 31 March 2005, appellant instructed Stacey to sell 500 shares in SA Retail Properties Limited (SA Retail) on behalf of Velocity Trading at 875 cps. At the same time he instructed Stacey to buy the same shares for the Mayibentsha Trust at 875 cps. Through Velocity Trading appellant was in control of both these funds and their trading accounts. Stacey entered the two orders into the market and as they matched the result was a purchase and sale of 500 SA Retail shares at 875 cps. As the last recorded sale before that was at 800 cps, the transaction effected by appellant had the result of increasing the last recorded price of SA Retail shares from 800 cps to 875 cps. Because the transaction took place at 16:37 shortly before the close of the market and as SA Retail was an illiquid share, i.e. a share that traded infrequently and in low volumes, no further transactions took place on 31 March 2005. The price of 875 cps thus became the reference price for SA Retail on 31 March 2005.

The transactions in regard to the Ifour and SA Retail shares were investigated by Respondent in terms of section 82(2)(a) of the Act. The investigation was conducted on behalf of Respondent by the Directorate of Market Abuse (the DMA) in terms of section 83(1)(c)(ii) of the Act. In its report dated 12 July 2007 the DMA found that in

regard to the transactions concerning both the SA Retail and the Ifour shares appellant may have contravened section 75(1) read with sections 75(3),(c),(d),(g), (h) and (i) of the Act. Following on the investigation by the DMA, Respondent referred the matter to the Enforcement Committee in terms of section 94(e) of the Act to be dealt with in terms of sections 102 to 105 of the Act. The recommendation of the DMA to the Enforcement committee was that an appropriate penalty would be no less than R10 million.

On 30 August 2005 the Registrar suspended the licence of Velocity Trading. On 4 October 2005, following on representations by appellant, the Registrar withdrew Velocity's licence with immediate effect and in terms of section 10(3)(a) of the FAIS Act, ordered that Velocity and appellant were debarred for a period of four years from re-applying for a licence. An appeal was noted against the period of the debarring and was enrolled for hearing on 7 September 2007. However, in his affirmation dated 22 August 2007, submitted to the Enforcement committee in terms of section 102(2) 0f the Act, appellant stated that he accepted the determination made by the Registrar in terms of section 10(3)(a) of the FAIS Act and that he had accordingly withdrawn the appeal. He stated further that he accepted the factual account of his conduct as summarized above and went on to affirm as follows:

> "I accept unequivocally that on 31 March 2005 I offended against the provisions of section 75 of the Security Services Act...by intentionally manipulating the price of shares in Ifour Properties Ltd...and SA Retail Properties Limited..."

He expressed his regret, made a commitment not to repeat the offences and offered to pay an administrative penalty of R250 000.

In considering the penalty to be imposed the Enforcement Committee stated:

> "In our view the contravention was deliberate and very serious. Not only was there a great potential of harm but it could prompt investors in the market to question the trustworthiness and credibility of the market. Subsection (c) raises the question of the quantum of losses suffered due to the contravention. In a case such as the present it is not possible to ascertain any exact figures. It can however be recorded that the contraventions involved significant levels of dishonesty and have the effect of adjusting the aggregate market capitalization of the relevant shares by more that R300 million. And as I have said, the question of potential harm is relevant".

The Enforcement Committee found, following the evidence of a witness, M D Shapiro, a quantitative analyst who made an affirmation is support of appellant, that appellant "probably made something between R4000 and R16000 from his scheme".

In regard to its obligation in terms of section 104(9)(f) of the Act to consider "any other factor that the panel considers relevant", the Enforcement Committee stated:

> "In our opinion a relevant factor is that of the deterrent effect of the imposition of a large penalty. Counsel for Respondents (i.e. appellant and Stacey who was charged with him) urged that it is significant that the Act does not in so many words spell out that deterrence is a factor. That is irrelevant. In our judgment this is such a self-evident fact that it need not have been said. It is in the context of the deterrent effect important that we are

> concerned with a market in which huge amounts are frequently traded by persons with considerable resources. Only if an amount, large by any standard, is fixed, will it have an adequate effect, or to put it more plainly, will it not make commercial sense for any other person to endeavour to embark on similar schemes".

In fixing the amount of the penalty to be imposed, the Enforcement Committee pointed out that the fact that the Act provided in section 115 for a fine of R50 million for a criminal conviction, "indicates an order". The Enforcement Committee accepted that to impose a penalty of the order suggested by the DMA would be ruinous and that the imposition of an administrative penalty well in excess of the R250 000 offered by appellant might well also be ruinous, but found that "the complaint by the [appellant] that he cannot afford a penalty in excess of R250 000 cannot be sustained". Having found that "the overriding factor is that of the deterrent effect" and that "the imposition of a large amount is indicated", the Enforcement Committee fixed an administrative penalty of R2 million.

It was contended on behalf of appellant that, in imposing an administrative penalty of R2 million, the Enforcement Committee overemphasized the importance of deterrence and failed to give adequate consideration to the factors which it was enjoined in terms of section 104(9) of the Act to consider. Section 104(9) provides that-

> "When determining an appropriate administrative penalty a panel must consider the following factors:
>
> (a) The nature, duration, seriousness and extent of the contravention or failure;

(b) the extent to which the contravention or failure was deliberate or reckless;

(c) the loss or damage suffered as a result of the contravention or failure;

(d) the level of profit derived from the contravention or failure;

(e) whether the respondent has previously been found in contravention of this Act;

(f) any other factor that the panel considers relevant".

Appellant's counsel, while conceding that deterrence was a relevant consideration, submitted that in the determination of a suitable administrative penalty, what was required was a degree of proportionality between the benefit to society and the hardship imposed upon the offender. In considering the hardship to the offender - so the argument ran - the affordability of the penalty was a factor to be taken into account. As appellant was clearly unable to afford the penalty imposed, the Enforcement Committee has, it was submitted, made an example of appellant at the expense of fairness.

Respondent's counsel, in supporting the penalty of R2 million, argued that - subject to the circumstances of the contravention and those of the offender – general deterrence was the primary consideration.

If one has regard to the objects of the Act, deterrence is undoubtedly of paramount importance when a penalty is imposed for a contravention of the type committed by appellant. In section 2 of the Act the objects are set out as follows:

" This Act aims to –

(a) increase confidence in the South African financial markets by –

(i) requiring that securities services be provided in a fair, efficient and transparent manner; and

(ii) contributing to the maintenance of a stable financial market environment;

(b) promote the protection of regulated persons and clients;

(c) reduce systemic risk; and

(d) promote the international competitiveness of securities services in South Africa".

Market manipulation of the kind committed by appellant conflicts directly with the integrity of the market which the Act is aimed at achieving. Appellant's conduct was not only fraudulent towards his clients who had invested in the hedge funds operated by him, but caused other players in the market to believe that the SA Retail and the Ifour shares were worth more than they actually were. This type of conduct calls for a penalty that sends a message to the public that practices that deflect from the objects of the Act are taken seriously and that anyone who might consider embarking on that type of conduct will be harshly treated. Having said that, however, the element of proportionality always requires that the circumstances of the contravention and those of the offender be given due consideration.

In an article entitled "Quantifying Regulatory Penalties: Australian Competition Law Penalties in Perspective" published in Melbourne University Law Review (1999) 18, Karen Yeung stated:

> "Because regulatory law's central concern is to modify behaviour by reference to its perceived undesirable effects on collective welfare, rather than to express moral condemnation of the offence, the theoretical justification for punishment of those who violate regulatory law appears to rest firmly on the deterrence theory of punishment".

She went on to state -

> "State punishment for regulatory offences should therefore encapsulate the essential concerns of both deterrence and desert theories of punishment. Assuming that the State is justified in regulating the proscribed activity by the imposition of penal sanctions, it is important that the severity of the sanctions should be sufficient to deter potential offenders from engaging in the proscribed conduct, otherwise the regulatory scheme is unlikely to be effective. The deterrence justification for regulatory offences suggests that the quantum of regulatory penalties should, in the first instance, be set at a level sufficiently high to deter the offender and others from contravening the law".

In her conclusion she stated the position thus –

> "A penalty scheme must not be too out of step with societal notions of fairness and justice, lest it fail to inculcate those who violate the law with a sense of the wrongfulness of their conduct, and lead to an erosion of public confidence in the regulatory system. Accordingly, it is suggested that a fair and effective regulatory penalty regime should combine the essential features of both models: penalties should be set at a level which are (sic) sufficiently high to deter future

contraventions of the law, provided that any given penalty is not disproportionate to the seriousness of the offence".

The views expressed by Yeung are equally applicable to the situation in South Africa.

Having regard to the importance of deterrence in the determination of the quantum of the penalty to be imposed, we agree with the approach of the Enforcement Committee that a "large" penalty was called for. In determining how large that amount should be, "affordability" which appellant's counsel submitted should be taken into account, is not a relevant factor in deciding whether the penalty imposed was appropriate in the context of the proportionality principle.

In a criminal case if the court decides to impose a fine as an alternative to imprisonment, the object is to give the accused the opportunity of paying a monetary penalty and thereby avoiding incarceration. If the fine imposed is one that the accused cannot pay, that object will be defeated. The present is not a criminal case. Appellant is not facing a prison sentence. If affordability were to place a limitation on the amount of the penalty to be imposed, the important consideration of deterrence could be defeated. If, for example, the offender were unable to pay a penalty of more than, say R1000, which would be a totally inadequate penalty, his affordability to pay an amount in excess of R1000 could not be a factor in fixing the quantum of the penalty. If the result of imposing a penalty in excess of what the offender can afford might result is his estate being sequestrated, that is not a factor that militates against the imposition of an appropriate penalty. Cf Australian Competition and Consumer Commission v High Adventure (Pty) Ltd. [2005] FCAFC 247, where

the Court of Appeal dealt with a statement by the judge in the court a quo that he had no intention of "impos[ing] penalties that would ruin the respondents", as follows:

> "...as deterrence (especially general deterrence) is the primary purpose lying behind the penalty regime, there inevitably will be cases where the penalty that must be imposed will be higher, perhaps even considerably higher, than the penalty that would otherwise be imposed on a particular offender if one were to have regard only to the circumstances of that offender. In some case the penalty may be so high that the offender will become insolvent. That possibility must not prevent the Court from doing its duty for otherwise the important object to general deterrence will be undermined".

This Board does not enjoy an unfettered discretion to interfere with the penalty imposed by the Enforcement Committee. We are, however, entitled to interfere if we find that the penalty imposed was excessive or was startlingly inappropriate. See Federal Mogul Aftermarket Southern Africa (Pty) Ltd. v Competition Commission and Another 2005 (6) BCLR 613 (CAC) at 636G. To determine whether we are entitled to interfere on this basis involves measuring the importance of deterrence against other relevant factors involved in arriving at a penalty that meets the requirements of proportionality. Applying this test, we have come to the conclusion that, having regard to the need for proportionality, the penalty imposed was in the circumstances excessive and startlingly inappropriate.

Although appellant's conduct resulted in the market capitalisation of the Ifour shares being increased by R148 207 642 and that of the SA

Retail shares by R155 960 565, according to the evidence of Shapiro the numerical impact on the market would have been "miniscule" in that the increase of R1 in the price of the Ifour shares would have increased the property section of the market by 0,322 per cent and would have increased the total JSE market by 0,0055 per cent. An increase in the price of the SA Retail shares by 75 cps would have increased the property section by 0,339 per cent and would have increased the total JSE market by 0,0057 per cent. The offence was committed on a single afternoon and did not involve a vast number of shares. Although the effect of these transactions was to falsely increase the value of the funds managed by appellant, his monetary gain was a relatively modest amount; the Enforcement Committee said it was "between R4 000 and R16 000" but according to appellant the additional management fees he received amounted to no more that R502,11. This was appellant's first offence and his plea of guilty is supportive of the contrition he has shown as confirmed by witnesses who testified on his behalf.

In our view a penalty of R1 million would have been sufficiently appropriate to send the correct message to the public that this type of conduct will not be tolerated and at the same time impress upon would-be offenders that it would not be worth their while to embark on this type of conduct. The difference between what we consider would have been an appropriate penalty to impose, taking into account all the relevant considerations referred to above, is sufficiently substantial to justify an alteration of the penalty.

That leaves the question of costs. The gravamen of the submissions on behalf of appellant was that the penalty should be reduced to R250

000 whereas it was contended on behalf of respondent that the penalty of R2 million was appropriate. In the result neither party can be said to have been substantially successful. The Enforcement Committee made no order as to costs as this was the first case of this kind to come before it. It is also the first time this Board has been called upon to consider a matter of this nature. In all the circumstances we are of the view that it would be appropriate if each party were to pay his/its own costs.

The appeal is upheld to the extent that the administrative penalty imposed by the Enforcement Committee is set aside and is replaced with the following:

"Appellant is ordered to pay an administrative penalty in an amount of R1 000 000. Each party is to pay his/its own costs".

Dated at Cape Town this 17th day of February 2009.

G Friedman

(Chairperson)

J D Pema

(Member)

D L Brooking

(Member)