PRICE MANIPULATION

Republic of the Philippines

A. Definition of Manipulation
   1. Generally, manipulation is defined as a series of transactions designed to raise or lower a price of a security or to give the appearance of trading for the purpose of inducing others to buy or sell.
   2. In essence, a manipulation is intentional interference with the free forces of supply and demand. Pagel, CCH 83,909 @ 87,751.
   3. "The purpose of the [Exchange Act] is to prevent rigging of the market [prices] and to permit operation of the natural law of supply and demand." United States v. Stein, 456 F. 2d. 844, 850 (2d. Cir. 1972).

B. Prohibitions Against Manipulation
   1. Section 10(b) of the Securities Exchange Act of 1934 and Rules 10b-5 and 10b-6 thereunder.
   2. Article III, Section 1 and 18 of the NASD Rules of Fair Practice.

C. Elements of a Manipulation Violation
   1. Initiate a series of transactions in a security;
   2. Designed to raise or lower the security's price or to give the appearance of trading;
   3. With the intent of affecting the price of the security (motive/manipulative purpose).

D. Series of Transactions
   1. As few as three consecutive purchases constitute a "series." Kidder Peabody & Co., SEC 559, 568 (1945).
   2. Placing consecutive bids in NQB sheets may satisfy the transaction requirement. Gob Shops, 39 SEC 92 (1959) (See, Cassin - bid constitute a transaction.)

E. Transactions to Raise or Lower Price or Give Appearance of Trading
   1. Wash Sales - A wash sale occurs when a customer enters a purchase order and a sale order at the same time through the same broker/dealer. The ownership of the stock does not change. This would normally be done to create the appearance of activity in a security. See, U.S. v. Minuse, 114 F. d. 36, 38 (1940).
   2. Matched Orders - Matched order occur when a customer enters a purchase order and a sale order at the same time, at the same price. In the case of matched orders the customer generally places the order through different broker/dealers. Matched orders may also occur using more than one customer and the same broker/dealer. Matched purchase and sale

transactions for the purpose of creating the false appearance of active trading are manipulative per se. Charles C. Wright, 12 SEC 100 (1942), aff'd 134 F. 2d. 733 (2d. Cir. 1943).

3. Increasingly Higher Bids
    a. "The insertion of increasingly higher bids for a stock in the sheets [without valid reasons] is an obvious device to create a false appearance of activity in the over-the-counter market and tends to support the price at an inflated level." Cassin, 10 SEC @ 975-76
    b. Progressively higher bids "Bearing no relation to the merits of the investment." Collins v. US, 157 F. 2d. 409 (1946).
    c. "One of the indicia of apparent activity is the inducement of other broker/dealers to quote the security in the sheets, for the more frequently a security is quoted, or the greater the number of dealers quoting the security, the broader and more active the appearance of the market for the security." Cassin, 10 SEC @ 976.
4. Upticking to Maintain the High Bid - Price Leadership
    a. Market Maker's consistently maintaining the highest bid may be a price support mechanism. Cassin, 10 SEC @ 976.
    b. "The price leadership resulting from [the underwriters] almost exclusive control of the source of supply empowers the underwriter to set prices arbitrarily. If that power is abused, the result is a manipulation." Pagel, CCH, para. 83,909 @ 87,751.
5. Transactions at Successively Higher Prices - The use of actual purchases and sales at successively higher prices has the effect of giving an appearance of activity and raises the price of an OTC security. Cassin, 10 SEC @ 977.
6. Domination and Control of Trading (Control of Float)
    a. Attempts to reduce a stock's floating supply (stock held by dealers and the public with a means to resale by purchasing approximately 2/3 of total market furthers manipulation). Cassin, 10 SEC @ 976.
    b. With control of float, respondents can "offer to purchase stock at increasingly higher prices, secure in the knowledge that they alone could sell any appreciable quantity. With such control they would be protected against would-be short sellers who would eventually have to come to them for stock with which to cover." Cassin, 10 SEC @ 976-77.
    c. "Customer sales exceeded customer purchases ... But respondents did not allow the excess sales to depress [the stock's] market price, the result that would normally

be expected in a free market. On the contrary, during the span of eight trading days, the price of [the stock] rose sharply ... Respondents simply absorbed the excess stock into inventory ... At that point, registrant and its customers held 93.7% of the... public offering." Pagel, CCH, para. 83,909 @ 87,751.

    d. Trader who purchases 50% or more of volume in wholesale market and upticks bid price to desired (but artificial) level despite absence of bona fide investor demand for the stock. Morgan First Sec. Inc., NASD, SEA-350.

7. "Marking the Close" - Placing actual or fictitious orders or fictitious quotations on NASDAQ or exchange listed stocks at or near the close of the trading day so as to frequently cause the stock to close at a price higher than the prior sales price. Walter T. Newman, Sec. Exch. Act Rel. No. 18932 (August 4, 1982) (Six fictitious AMEX options transactions at the close); Kenneth Sonken, Sec. Exch. Act Rel. No. 24828 (August 20, 1987) (One "artificial" quotation on CBOE option after the close of trading to change the option's closing price).
8. Pre-Arranged Trading - Agreements in advance of opening after-market trading concerning the price at which securities transactions will occur and the amount of securities to be involved in trades, are manipulative. Richard Bolton, NASD, NY-3012 (transactions prearranged at increasingly higher prices); See, SEC v. Rega, CCH Para. 95-222 (setting artificial prices).
9. Bidding or Purchasing During Distribution (Rule 10b-6) - "Distribution participants" (including underwriters, selling group members, issuer or selling shareholders and their affiliates) bidding for, purchasing or inducing other persons to bid for or purchase the stock while the distribution is continuing.
10. Guarantees/Payments
    a. Guaranteeing purchases against loss. Minuse, 114 F. 2d. @ 38.
    b. Making cash payments to persons who induce others to purchase the security. Minuse, 114 F. 2s. @ 38; R.J Koeppe & Co., et al. v. SEC, 95 F. 2d. 550, 552 (1938).
11. Use of Nominee Accounts to Conceal - Trader's use of such accounts to stage widespread buying or selling activity at designated price levels, thereby concealing the actual control and purpose of such activity. Thomas McGhee, SEC Rel. No. 20852 (April 1984).

F. Intent to Affect Price (Motive/Manipulative Purpose)

1. Manipulative purpose is the intent to affect prices (through a series of transactions) for the purpose of inducing others to buy

or sell. Russell Maguire & Co., 10 SEC 332, 347 (1941). Proof of purpose to induce others to purchase is not required to establish a Rule 10b-5 manipulation. Pagel, CCH, para. 83,909.

2. A motive to manipulate may infer the requisite intent to affect prices. See, In the Matter of Federal Corp., 25 SEC @ 227, 230 (1947).
3. Downward price manipulation allowed respondent to purchase large position and realize tax loss to offset broker/dealers trading profits. Pagel @ 87,751.
4. Direct financial interest in price rise due to holdings of substantial long position in stock and warrants. Gob Shops, 39 SEC @ 98,105.
5. Price manipulation necessary to fulfill promises made to induce earlier purchasers to buy the security. Cassin, 10 SEC @ 967.
6. Purpose of fraudulent conduct was "to lend a fictitious appearance of worth to the [issuer's] stock." Collins, 157 F. 2d. @ 409.
7. Conduct to increase price engaged in "for the purpose of raising and maintaining the price of the stock at an artificially fixed price level at which the new share would be and were distributed." In the Matter of R.L. Emacio & Co., Inc. 35 SEC 191, 199 (1953). See also, Federal Corp., 25 SEC @ 230.
8. To assure receipt of commission as selling group member. Cassin, 10 SEC @ 987.
9. The existence of secured loans which would be callable if the stock fell below a specific price. SEC Rel. No. 3056, CCH para. 22,565.
10. To unload large inventory position at a profit. Koeppe 95 F. 2d. @ 552.

G. Proof of Manipulation (Generally - Circumstantial Evidence)

1. "Since it is impossible to probe into the depths of a man's mind, it is necessary in the usual case ... that the finding of manipulative purpose be based on inferences drawn from circumstantial evidence." Federal Corp., 25 SEC @ 230 (1947).
2. Absent an admission, usually a finding of manipulative purpose must be based on inferences drawn from circumstantial evidence. Federal Corp., 25 SEC @ 230.
3. Collapse of market when manipulator ceases activity supports manipulation. Cassin, 20 SEC @ 976, Koeppe, 95 F. 2d @ 522. (However, price decline is not necessary. See, Pagel.)
4. A prima facie case of manipulative purpose (intent to affect prices) exists when evidence of a series of transactions is coupled with a motive to manipulate. Halsey Stuart & Co., 30 SEC 111 (1949).

5. Manipulative purpose also may be inferred from the person's pattern of trading in the security, such as consistently appearing as the higher bidder (See, Charles C. Wright), or from activities designed to increase or reduce demand. (See, R.L. Emacio).
6. It is sufficient proof of manipulation if the manipulator caused either actual or apparent activity or caused a side in the market price. Cassin, 10 SEC @ 976.
7. "Proof of a manipulation almost always depends on inferences drawn from a mass of factual detail. Findings must be gleaned from patterns of behavior, from apparent irregularities, and from trading data. When all of these are considered together, they can emerge as ingredients in a manipulative scheme designed to tamper with free market forces." Pagel, CCH, Para. 83,909 @ 87,752.

H. General Investigatory Steps for a Market Manipulation Investigation

1. Preliminary Analysis of the Suspicious Price Movement
    a. Determine the extent of the price movements during the period.
    b. Determine whenever any dealer dominated (over 50%) inter-dealer trading.
    c. Determine whether any broker/dealer was regularly the highest bidder or the highest offeror.
    d. Determine whether any dealer significantly lead all others in upticks.
    e. Determine whether any dealer had significant long or short positions in the stock.
    f. Determine whether any news releases were published concerning the stock before or during the price movement period.
    g. Determine general market conditions and conditions in the issuer's industry during the period.
2. Gather Records Concerning Broker/Dealers, Issuer, and Customers
    a. Broker/Dealers:
        i. Trading information for the period (See Blue Sheet Questionnaire).
        ii. Firm Trading Records: Order tickets (with legible time stamps); Confirmation slips; Purchase and Sale blotter; Stock inventory records; Quotation records; Trader's book; P&L for the stock; Stock options.
        iii. Customer Account Information: New account card, all customer agreements; Power of attorney; Copies of all checks payable to the customer; Correspondence; Sales and

promotional literature; Customer complaint letters; Customer account statements; Customer confirmation slips.

iv. Firm Trading Account Information: Daily Stock inventory position; Pricing procedures and standards; daily stock trading report (P&L).

v. Compliance Data: Firm/Branch office audit report; Reports of compliance review; Firm procedures manuals (back office, branch office managers, account executives).

vi. NASDAQ Stock Data: Market Maker Price Movement Report; Uptick Report; TMTR Report.

vii. Non-NASDAQ Stock Data.

b. Issuer:

Press releases; purchases and sales by officers/directors; proxy material; annual and quarterly reports; research reports; filling with the Commission; SEC name and relationship search.

c. Customer:

Sales literature and promotional materials received; notes of telephone calls; complaint letters. (Customer questionnaires and/or interviews may be used to determine retail sales practices.)

3. <u>Reconstruct Trading History and Analyze Data</u>
    a. Define the time period of the price movement. (Also define a reasonable period before and after that movement for comparison purposes.)
    b. Schedule the daily price history (in time sequence) before, during, and after the period. (For data sources, see NASD "TMTR Report" for NASDAQ/NMS stocks; Order tickets and/or "Pink Sheets" for non-NASDAQ stocks.)
    c. Schedule the daily opening and/or closing prices for "marking the close" patterns and other unusual price increases or decreases.
    d. Schedule the daily purchase and sales volume before, during, and after the period. (For data sources, see ASR Report.)
        i. Reflect the percent of total volume by each dominant purchaser or seller.
        ii. Analyze for any volume trading patterns, such as "parking."

   e. Schedule the bid and ask quotations by dominant dealer purchasers or sellers. (For data source, see Market Maker Price Movement Report.)
      i. High bidder or high offeror analysis.
      ii. Upticker or downticker analysis.
   f. Schedule the daily stock inventory position of dominant dealer purchasers or sellers.
   g. Schedule the daily purchases and sales during the period.
   h. Schedule the amount of trading profits to dominant dealer purchasers or sellers.
4. <u>Analyze Data as to Retail Sales Practices, Including Whether False and Misleading Statements were Made to Investors to Stimulate Demand</u>
5. <u>Analyze Evidence of any Motive to Manipulate</u>
6. <u>Question Witnesses</u> - Including Customers, Firm Personnel (Account Executives, Branch Office Managers, Traders), Bankers, Secretaries, Issuer Personnel
7. <u>Request Additional Documents not Already Obtained</u> (Telephone Records, Bank Accounts, Desk Calendars, Correspondence, etc.)