The perils of calling the bankers:
Is there a problem with selective disclosure to non investors?

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Abstract

ASIC, like various overseas regulators, has identified selective disclosure to securities analysts as a particular evil to be discouraged. Securities analysts are not however the only persons who may receive selective disclosure of material or price sensitive information from a corporation. Financiers, suppliers, employees and insurers may all potentially receive price sensitive information that is yet to be publicly announced to the market. The article asks whether this is likely to be a concern or whether assurances that such other persons will not trade is sufficient to dispel anything problematic about such disclosures. To the extent that there are problems with such disclosures companies may find themselves in the position of having to simultaneously make disclosures to the market lest they infringe the continuous disclosure laws.

INTRODUCTION

Australia introduced the requirements of continuous disclosure for listed companies in 1994 for the benefit of stock market participants and to reduce the quantity of "inside information" available and therefore the opportunities to trade on same. Information that is material to a company's share price is to be disclosed promptly to the market through disclosure to the Australian Securities Exchange (ASX). The problem of selective disclosure to share market analysts has been identified as a problem by regulators however there has been little analysis of the question of disclosures to other entities with whom the corporation has close relationships. These include financiers, suppliers, employees, insurers and regulators and it is these groups that I will focus on in this paper (and to whom I will refer to as "non investors" though they might perhaps be more correctly described as "non equity-investors"). The question of disclosure to non investors may be a practical problem as in some cases matters disclosed to non investors may have been price sensitive and otherwise meeting the tests for disclosure under section 674. If there is disclosure to non investors of information that does not satisfy the carve out in listing rule 3.1A then this may constitute selective duisclsoure. Evidence that information has been selectively disclosed to non investors might raise the question as to why it was not disclosed to investors as well. This will be particularly relevant in proceedings for breach of the continuous disclosure provisions, whether brought by ASIC under its new infringement notice powers or by private litigants seeking declarations and damages. In Part A of this paper I will set out a general history of the continuous disclosure provisions in Australia and in Part B I will set out the current law. Part C will examine the phenomenon of "selective disclosure" and in Part D I will look briefly at how the issue is dealt with in the listing rules of the United Kingdom and United

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States. Lastly I will conclude noting the potential pitfalls of disclosure in the context of these relationships.

GENERAL HISTORY OF THE CONTINUOUS DISCLOSURE PROVISIONS IN AUSTRALIA

To understand whether there is a problem with selective disclosure to non investors it is necessary to have regard to the purpose and evolution of the continuous disclosure laws. The introduction of continuous disclosure provisions into the *Corporations Law* in 1994[1] followed a report by the Companies and Securities Advisory Committee (CASAC) in September 1991. CASAC's report concluded that a statutory based system of continuous disclosure would provide greater investor confidence in the integrity of Australian capital markets and provide benefits to market participants and management in various ways. It was said that it would:

- overcome the inability of general market forces to guarantee adequate and timely disclosure by disclosing entities;
- encourage greater securities research by investors and advisors, thereby ensuring that securities prices more closely, and quickly, reflect underlying economic values;
- ensure that equity and loan resources in the Australian market are more effectively channelled into appropriate investments, and that funds are withheld or withdrawn from poorly performing disclosing entities. This will promote capital market efficiency;
- assist debt holders in monitoring the performance of disclosing entities and thereby determine whether, or when, to exercise any right to withdraw or reinvest their loan funds, or convert debt to equity;
- act as a further, or substitute warning device for holders of charges over corporate assets, that breaches in covenants may have taken place, or the risk of default has increased;
- assist potential equity or debt holders of disclosing entities to better evaluate their investment alternatives;
- lessen the possible distorting effects of rumour on securities prices;
- minimise the opportunities for insider trading or similar market abuses;
- improve managerial performance and accountability by giving the market more timely indicators of corporate performance;
- encourage the growth of information systems within disclosing entities. This assists directors in their decision making and compliance with their fiduciary duties; and
- reduce the time and costs involved when preparing takeover and prospectus documents.[2]

The original bill was introduced into the Senate in November 1992. There were indications that the proposed disclosure system would be directed toward investors rather than creditors[3] however in the event, that bill, like the eventual law, declared that debentures would also be considered "enhanced disclosure" (ED) securities to the extent that the requirement of a trustee for debenture holders applied to those debentures.[4] That bill however lapsed with the calling of the 1993 election.[5] A new bill was then drafted which had a number of differences. The most significant of these was that the system would be administered by the Australian Stock Exchange

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[1] By the *Corporate Law Reform Act 1994 (Cth)*.
[2] Companies and Securities Advisory Committee (CASAC) Report on an Enhanced Statutory Disclosure System (undated though published September 1991) P7.
[3] Blair, Mark. "The debate over mandatory corporate disclosure rules" (1992) 15 *NSWLJ* 177 at 182.
[4] Section 22F *Corporate Law Reform Bill (no 2*) 1992 (Cth). The trustee for debenture holders is a "consumer protection" measure focused on retail investors.
[5] Commonwealth, *Parliamentary Debates* (Hansard), House of Representatives, 1 February 1994, p56 (A.C. Rocher - Member for Curtin)

rather than the Australian Securities Commission. This would eliminate the problems of creating two different overlapping disclosure systems.[6]

The provisions came into operation on 4 September 1994. They provided that where the listing rules of a securities exchange required an entity to notify the securities exchange of information for the purpose of the securities exchange making that information available to a stock market conducted by the securities exchange then:

> The disclosing entity must not contravene those provisions by intentionally, recklessly or negligently failing to notify the securities exchange of information:
> (a) that is not generally available; and
> (b) that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED [enhanced disclosure] securities of the entity.[7]

Thus, under the original provisions the disclosing entity's failure to notify the Securities Exchange had to be done "intentionally, recklessly or negligently." Officers of the disclosing entity could also be criminally liable as accessories.[8]

Civil liability also attached if the failure was intentional, reckless or negligent and loss and damage could then be recovered from the disclosing entity.[9] Under section 79 it might also be recovered from any person "involved" in the contravention.[10]

The provisions were later redrafted and relocated with the introduction of chapter 6CA (Continuous Disclosure) into the Act by the *Financial Services Reform Act 2001 (Cth)* effective from 11 March 2002.

The redrafting made it clear that the provisions provided for both a criminal offence and civil penalty. They also removed the requirement that the disclosing entity's failure to notify the Securities Exchange had to be done "intentionally, recklessly or negligently" and replaced it with the default "fault elements" set out in the Criminal Code.[11] The result was that, in most instances, the default fault elements specified in the Criminal Code of intention in relation to conduct and recklessness in relation to results or circumstances were to be implied into offences.[12]

This clarified somewhat the criminal aspects of the provisions. In further amendments in 2004 an offence was created in relation to a person who was involved in a disclosing entity's contravention (though as noted above this effectively already

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[6] Commonwealth, *Parliamentary Debates* (Hansard), House of Representatives, 15 December 1993, P4083 (Mr M Lavarch, Attorney General).
[7] S1001A (2) of the former *Corporations Law (Cth)*.
[8] *Crimes Act (Cth)* s5. Referred to at paragraph 2.14 of CASAC *Report on Continuous Disclosure* November 1996.
[9] S1005 of the former *Corporations Law (Cth)*.
[10] S79 *Corporations Law (Cth)* (which is unchanged in the *Corporations Act 2001*)
[11] See current section 678 *Corporations Act 2001 (Cth)*. The *Criminal Code Act 1995 (Cth)*.was introduced following the Review of Criminal Law, headed by Sir Harry Gibbs in 1990 which recognised that many aspects of the existing Commonwealth criminal law system were fragmented and unclear, and that a more uniform, less complex system was required. The Code was enacted to codify all relevant principles of criminal responsibility and commenced operation on 1 January 1997.
[12] Paragraph 6.115 Explanatory Memorandum to *Financial Services Reform Bill 2001(Cth)*.

existed under section 79) but also created a specific due diligence defence.[13] The issue of a due diligence defence had been raised in one of the submissions to CASAC's 1996 Report on Continuous Disclosure.[14]

THE CURRENT LAW

The current section 674 of the *Corporations Act* thus gives legislative force to the listing rules of the ASX. It applies to a listed disclosing entity where the entity is required by provisions of the listing rules of the market to notify the market operator of information for the purpose of the operator making that information available to market participants.[15]

Section 674(2) provides that:

> (a) if this subsection applies to a listed disclosing entity; and
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> (b) the entity has information that those provisions[of the Listing Rules] require the entity to notify to the market operator; and
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> (c) that information:
>
> (i) is not generally available; and
>
> (ii) is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities of the entity;
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> the entity must notify the market operator of that information in accordance with those provisions.

In relation to companies listed on the Australian Securities Exchange the relevant "market operator" will be the ASX.

Materiality

Section 674(2)(c) of the *Corporations Act* establishes the requirement of "materiality" based on the reasonable person as part of the overall test in s 674(2).
Section 677 defines materiality as follows:

> For the purposes of sections 674 and 675, a reasonable person would be taken to expect information to have a material effect on the price or value of ED [enhanced disclosure] securities of a disclosing entity if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the ED securities.

It has been suggested that the materiality law is based upon the United States "reasonable shareholder" test[16] (described by at least one US academic as the

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[13] See sections 675(2A) and 675(2B) *Corporations Act 2001(Cth)* (introduced by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* No 103, 2004
[14] See para 3.59 CASAC *Report on Continuous Disclosure* November 1996.
[15] S 674(1) *Corporations Act 2001(Cth)*.
[16] Austin RP and Ramsay, I.M., *Ford's Principles of Corporations Law*, (13th edition Butterworths 2007) Paragraph 10.300

"mythical" reasonable investor[17]). One issue about that test is the degree of likelihood that the information would affect that reasonable investor. The US law requires that there be a "substantial likelihood" that the information would influence the reasonable shareholder rather than that it "might" do so.[18] Section 677 above requires that it "would or would be likely" to do so which appears to follow the US approach.[19]

The materiality definition in s677 (and its twin in the insider trading provisions - section 1042D) is also not without ambiguity. Though section 674 simply requires that the reasonable person expect that the information, if generally available, would have a material effect on the share price, the further definition in s677 arguably confuses matters. This is because, for section 677 to add anything to the section 674 definition it must be interpreted to mean that the reasonable investor will be taken to so expect if other shareholders so expect. This appears to focus effectively on what the reasonable shareholder thinks other shareholders will do. It is not clear that the other shareholders are required to be "reasonable". It also talks about "persons" who commonly invest in such shares but is not clear whether it means all such persons (ie the entire market for the shares) or just some of these persons.

It can be seen that the definition attempts to distil a test from a number of different stages of enquiry. The first stage concept is what the reasonable shareholder thinks about the information as information. The second stage is what all other investors (the market) think about the information as information. The third stage is what the reasonable investor thinks all other investors (the market) will think about the information. The fourth stage is what the reasonable investor thinks each investor in the market will think all other investors will think about the information and so on (potentially into an infinite regress).[20] Section 674 as interpreted through section 677 thus goes beyond the stage one and two enquiry to stage three.[21]

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[17] Steinberg MI "Insider trading, selective disclosure, and prompt disclosure", 22 *U. Pa. J. Int'l Econ.L.* 637 2001.

[18] Austin and Ramsay above n 16. According to Austin and Ramsay this appears to adopt the test in *TSC Industries Inc v Northway Inc* 426 US 438 at 449where the US Supreme Court rejected a formulation of materiality which would include "all facts which a reasonable shareholder might consider important" in favour of "a showing of a subtstantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder".

[19] Though as noted by Austin and Ramsay above n 16 the test may be different in a takeover context in relation to the disclosure of "other material information" in a bidder's statement where possibility of influencing the reasonable investor may be enough. See *Pancontinetal Mining Ltd v Goldfields Ltd* (1995) 16 ACSR 463.

[20] J M Keynes has illustrated the potential ifinite regress of materiality as follows:

> Professional investment may be likened to those newspaper competitions in which the competitors have to pick out the six prettiest faces from a hundred photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preferences of the competitors as a whole; so that each competitor has to pick, not those faces which he himself finds prettiest, but those which he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view. It is not a case of choosing those which, to the best of one's judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be. And there are some, I believe, who practise the fourth, fifth and higher degrees…"
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> See J M Keynes, *The General Theory of Employment, Interest and Money*, 1936.

[21] In the US it has been argued that the reasonable investor enquiry from *TSC Industries Inc v Northway Inc* above n 18 (and expressly adopted in *Basic Inc v Levinson* 485 US 224, 231–2 (1988))

At the end of the day materiality will be mainly a question of fact and the facts will be specific to the particular entity and its investors.[22]

General availability

Section 676(2) also provides an additional requirement before legislative force is given to the listing rules. This requirement is that the information is not generally available. General availability is defined in section 676 as follows:

> (2) Information is generally available if:
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> (a) it consists of readily observable matter; or
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> (b) without limiting the generality of paragraph (a), both of the following subparagraphs apply:
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> (i) it has been made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in securities of a kind whose price or value might be affected by the information; and
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> (ii) since it was so made known, a reasonable period for it to be disseminated among such persons has elapsed.
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> (3) Information is also generally available if it consists of deductions, conclusions or inferences made or drawn from either or both of the following:
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> (a) information referred to in paragraph (2)(a);
>
> (b) information made known as mentioned in subparagraph (2)(b)(i).

The concept of general availability comes from the insider trading laws where it is also highly relevant. For the purposes of the insider trading provisions part of the definition of "inside information" is that the information is not generally available (the other part of the definition being materiality).

The definition of general availability for the purposes of insider trading is contained in section s1042C and is identical to s676 save for a minor drafting difference.[23]

Though general availability has not been given a great deal of consideration in the context of continuous disclosure there have been a number of cases on the subject in the context of insider trading. It seems likely that these authorities would be relevant to general availability in the context of continuous disclosure. Two important cases have focused on the issue of what is readily observable. Initially they came to different conclusion even though they arose from a common fact situation; on appeal the results were harmonised.

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should be discarded and should be replaced by an enquiry into whether the information actually did cause the security to trade at an artificially high or low price, rather than whether the information would be material to the 'reasonable investor'. See Fischel DR, 'Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities' (1982) 38 *Business Lawyer* 1. .

[22] *Flavel v Roget* (1990) 1 ACSR 595

[23] It omits "*without limiting the generality of paragraph (a)" in* the opening part of section 676(2)(b). It is not entirely clear what practical difference this would make.

The two judgments are *R v Kruse* [24]and *R v Firns*.[25] The latter went to the Court of Appeal where the decision at first instance was reversed. Both cases involved an ASX-listed mining company operating in Papua New Guinea (PNG). The company was involved in a case regarding mining rights in PNG and on 28 July 1995 the PNG Supreme Court handed down its judgment.

In the *Kruse* case, Mr Kruse had been in the PNG Supreme Court when judgment was handed down and shortly thereafter telephoned his broker to purchase shares. O'Reilly J. found that for information to consist of readily observable matter the relevant facts must be directly observable in a public arena but the public arena did not need to be in Australia. His Honour found that what occurred in the PNG Supreme Court was in the public arena. It therefore was found to constitute readily observable matter for the purposes of s 1042C(1)(a) and the defendant was therefore acquitted. The Judge did say that a matter might not be readily observable if it happened in a remote area in a situation where there is no dissemination of information.

In *Firns* however at first instance[26], Sides J held that the giving of judgment by the PNG Supreme Court was not a readily observable matter as it was not readily capable of being noticed or perceived in Australia. The fact that details of the judgment could become available in Australia through a telephone call was not enough to make it "readily observable".

This was reversed however in *R v Firns* [27] where the Court of Criminal Appeal of the Supreme Court of New South Wale found that the giving of the judgment in open court did constitute a readily observable matter.

Mason P (with Hidden J agreeing) found[28] that information may be readily observable even if no one observed it. He found that the information in the Supreme Court judgment was "available, understandable and accessible to a significant group of the public, that is, those present and capable of being present in court in the ordinary course".[29] He found that Division 2A is not confined to protecting the interests of resident Australian investors or dealings in Australian shares. Mason P also found that a published judgment of the highest appellate court in a country would be readily observable in every circumstance that he could conceive of. [30]

The Listing Rules

As has been noted there is a requirement that both the legislation and the Listing Rules require disclosure. The requirements of continuous disclosure under the ASX Listing Rules partly replicate section 674(2) however are subject to carve outs. Under Rule 3.1 of the *Listing Rules*:

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[24] Unreported District Court of New South Wales, O'Reilly J, 2 December 1999, No 98/11/0908
[25] Unreported District Court of New South Wales, Sides J, 4 November 1999, No 98/11/0895 (though the decision in *Firns* was subsequently reversed in *R v Firns* (2001) 51 NSWLR 548 (2001) 38 ACSR 223).
[26] Ibid
[27] Ibid
[28] Ibid at 564 (para 77).
[29] Ibid at 563 (para 76).
[30] Ibid at 566 (para 91).

> 'Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.'[31]

The obligation to notify ASX is a stringent one. It is clear that ASX must be notified before any other party. Paragraph 22 of ASX Guidance Note 8 makes this very clear. It states:

> An entity must not disclose information that is for release to the market to anyone until it has given the information to ASX, and has received an acknowledgement from ASX that the information has been released to the market, refer listing rule 15.7 and Guidance note 14 – Company Announcements Platform. This includes the release of information to the media, even on an embargoed basis. ASX does not recognise embargoes.[32]

The stringency of this approach is however subject to carve-outs in Rule 3.1A of the *Listing Rules*. The carve-out states that Rule 3.1 of the *Listing Rules* does not apply to particular information where all of the following are satisfied:

3.1A.1 A reasonable person would not expect the information to be disclosed.

3.1A.2 The information is confidential and ASX has not formed the view that the information has ceased to be confidential.

3.1A.3 One or more of the following applies:

- It would be a breach of a law to disclose the information.
- The information concerns an incomplete proposal or negotiation.
- The information comprises matters of supposition or is insufficiently definite to warrant disclosure.
- The information is generated for the internal management purposes of the entity.
- The information is a trade secret.

In relation to the definition of "confidential" information. The ASX Guidance Note No 8 on Continuous Disclosure provides that:

> 34. The second requirement of the exception is that the information is confidential and ASX has not formed the view that confidentiality is lost. It would be unusual practice for ASX to consult with the entity about any disclosure concerns relating to confidentiality. If ASX forms the view that confidentiality has been lost, it will tell the entity immediately. 'Confidential' in this context has the sense of 'secret'. It means that the information is in the possession of only those who will not trade in the entity's securities and there is control over the use of the information. If it is clear that the information is no longer confidential or ASX has formed that view, listing rule 3.1A.2 is no longer satisfied and the exception no longer applies. This is the case even if the entity has entered into confidentiality arrangements and/or the information has come from a source other than the entity.
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> 35. Loss of confidentiality may be indicated by otherwise unexplained changes to the price of the entity's securities, or by reference to the information in the media or analyst's reports. ASX will take all the circumstances of each case into consideration in deciding whether it considers that confidentiality has been lost. It would be more likely to consider that confidentiality has been lost where references to the entity or its proposals are significant and credible and the details are reasonably specific.
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> 37. ASX accepts that confidentiality is not lost simply because information is given to an entity's advisers, a person with whom the entity is negotiating, or regulatory authorities, if it is

[31] See Australian Stock Exchange, *Listing Rules* (2003) 302 <http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf>.

[32] ASX Guidance Note No 8 on Continuous Disclosure. Issued June 2005. Paragraph 22.

> to be given on a basis that restricts its use to the stated purpose. However any release of the information from any source, however inadvertent, will mean that listing rule 3.1A.2 is no longer satisfied.[33]

Thus there is the possibility of information being given to certain third parties in a situation where confidentiality is maintained. For this to be permissible however it would require that the other limbs of Listing Rule 3.1A are satisfied. It would need to be the case that a reasonable person would not expect the information to be disclosed to ASX and the information would need to satisfy one of the criteria in 3.1A.3, namely that:

- It would be a breach of a law to disclose the information or;
- The information concerns an incomplete proposal or negotiation or;
- The information comprises matters of supposition or is insufficiently definite to warrant disclosure or;
- The information is generated for the internal management purposes of the entity or;
- The information is a trade secret.

There is clearly a real question about how widely disseminated information has to be before confidentiality is lost. The decision appears to be very much in the hands of ASX which reserves itself the power to decide whether dissemination is so wide that confidentiality has been lost. An important factor may be whether the dissemination is so wide as to move the market however determining whether this has occurred is by no means a simple issue.[34]

The focus of this paper is to look at situations where information may be given to third parties in a manner where the carve-out in 3.1A cannot be established and which therefore may constitute selective disclosure. The question will be who, besides analysts, might receive selective disclosure and the implications of this in terms of a company's continuous disclosure obligations generally.

The enquiry is not of academic interest only. ASIC is active in policing the disclosure obligations of corporations[35] and the rise of securities class actions based upon misleading or non disclosure by corporations[36] may mean that disclosures that have been made to bankers or others may provide a basis for arguing that such disclosures should have been made to the market generally (and documentary evidence of such disclosures may be discoverable in litigation). The fact that disclosure of information is valued by a financier or supplier for instance may suggest that it has attributes that would be valued by the market as a whole. Those attributes may include anything impacting upon the creditworthiness of a company and that type of information is

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[33] ASX Guidance Note No 8 on Continuous Disclosure issued June 2005. Paragraphs 34, 35 and 37.

[34] Some of the complications of determining whether information has moved the market price of a security are noted in an influential article by Fischel. These include the effect of general market sentiment, industry sentiment or other matters affecting the firm itself. See Fischel above n 21.

[35] The introduction of continuous disclosure infringement notices (s1317DAC) from July 2004 has added considerably to ASIC's armoury of remedies. See generally Nehme, M, Hyland, M, & Adams, M; "Enforcement of continuous disclosure: The use of infringement notice and alternative sanctions"" (2007) volume 21 (December) *Australian Journal of Corporate Law* pages 1 – 22; Michelle Welsh, "Enforcing contraventions of the continuous disclosure provisions: Civil or administrative penalties", *Company & Securities Law Journal* 25(5) (2007).

[36] See for instance Spender P, 'Securities Class Actions: A View from the Land of the Great White Shareholder' (2002) *Common Law World Review* 123 at 127.

likely to be material or price sensitive. Certainly the proponents of maximum disclosure would seek to make such an argument. Intrinsic in such an argument would be the proposition that the fact of such disclosure is evidence of materiality and rebuttal of each of the matters contained in Listing Rule 3.1A.3 (ie the carve outs which set out when information need not be disclosed). Thus for instance it would be argued that the information was sufficiently definite or complete to warrant disclosure otherwise the information would have been of no interest to the corporation's financiers or creditors (who we may presume are looking for something tangible to give them comfort).

Even so however, if only one of the said carve outs applies then, providing the information is confidential and a reasonable person would not expect disclosure, there will be no requirement of disclosure.

Selective disclosure

In November 1999 ASIC published a "Consultation Paper" entitled `Heard it on the grapevine ...'[37] The paper sought to offer guidance to companies on disclosure of information to investors and compliance with continuous disclosure and insider trading provisions. It focused on the avoidance of "selective disclosure", a term which was used throughout the paper though not specifically defined. There was also reference to "selective briefings". The focus of the paper was on private briefings to analysts, institutional investors and fund managers. It advised that listed companies should establish disclosure practices which minimise the likelihood of selective disclosure and also noted that:

> Analyst's briefings and other forms of selective disclosure have increasingly become a cause for concern amongst regulators in Australia and overseas.[38]

ASIC stated that it wanted to encourage the flow of information between listed companies and investors and analysts however was concerned that selective briefings "can create opportunities for insider trading and also undermine ordinary investors' confidence in the market as a level playing field."[39] It was also concerned that private briefings "create a perception that institutional investors and fund managers have access to information that is not available to other investors."[40]

On 23 August 2000 ASIC issued a document entitled "Better Disclosure for Investors". It focused on preventing selective disclosure and developing disclosure procedures and in particular on practices in relation to the briefing of analysts.[41] Besides analysts it did not focus on any other specific groups to which there may have been a risk of selective disclosure.

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[37] ASIC Consultation Paper "Heard it on the grapevine…" Draft ASIC guidance and discussion paper November 1999 <'http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/analysts_briefings.pdf/$file/analysts_briefings.pdf > viewed 8 February 2008
[38] Ibid p4.
[39] Ibid.
[40] Ibid.
[41] The term "selective briefings" was not used in this document. This was said to be due to the views of industry. See Lyon, G and Du Plessis,,J *The Law of Insider Trading in Australia*, 2005.

In a comprehensive review of Australia's continuous disclosure laws in 2004 Golding and Kalfus gave a definition of selective disclosure as "disclosing significant information to participants in the securities market (particularly securities analysts) when that information has not been generally disclosed."[42]

It would thus appear that the selective disclosure problem is generally seen as a problem of selective disclosure to participants in the market or analysts who report to participants in the market (as opposed to disclosure to those who are not direct participants in the market for those securities). This may be because it is members of the market who by definition may trade in the securities and selective disclosure has the effect of making the recipient an insider. He or she receives information that is both:

(a) not generally available;
(b) if it were generally available, a reasonable person would expect it to have a material effect on the price or value of the shares.

On the other hand any person is potentially a participant in the market. This is so particularly in the modern world given the relative ease and lack of expense of online trading.[43] The focus on selective disclosure to analysts may therefore arise more from addressing a problematic industry practice than from a theoretical basis.

In the US it has been argued[44] that reasons for the focus on avoiding selective disclosure included the following:

(1) A belief that issuers often disclose important non-public information, such as advance warnings of earnings results to securities analysts and/or institutional investors before making such information available to the general investing public. This could lead to the public concluding there was not a level playing field and therefore losing confidence in the integrity of the securities markets;
(2) The fact that selective disclosure closely resembles "tipping" of inside information though the US insider trading law may not catch such conduct;
(3) A perceived threat to market integrity if issuers selectively disclosed information as a means of receiving favourable reviews by analysts in return;
(4) The fact that technological advances such as the internet made timely public disclosure more effective.

Selective disclosure – the relationship to the insider trading provisions

As can be seen from the above the insider trading provisions have a close relationship with the continuous disclosure provisions through the common or substantively common definitions of such concepts as materiality and general availability. The

[42] Golding G and Kalfus N, "The continuous evolution of Australia's continuous disclosure laws" (2004) 22 *C&SLJ* 385 at 388.
[43] Kingsford Smith D, 'Online investing and the online consumer: State and decentred regulatory responses'. (2004) 26(3 & 4) *Law and Policy* 371-374.
[44] Steinberg above n 17 at 649-650.

cognate relationship is fortified by the fact that the Australian insider trading provisions are said to be based partly on the equal access theory.[45] In his judgment in *R v Firns,*[46] Mason P noted the legislative history of the provisions and reviewed some of the arguments that had been made in support of the regulation of insider trading and concluded that Parliament had come up with a scheme embodying the embrace of the "equal access" and "market efficiency" theories.'[47] This is in contrast to the US position where the insider trading laws are bound up with various concepts focusing on fiduciary duty to the company,[48] misappropriation of information[49] and financial benefit.[50]

The "fairness" or "equal access" theory is fairly integral to the argument against selective disclosure as selective disclosure by its nature causes unequal access to information.[51]

The cognate nature of the insider trading and continuous disclosure definitions may also provide some illumination on the confidentiality carve out to the continuous disclosure obligations. Under section 1043A(2) of the insider trading provisions a person who gives inside information to another person (ie "tips" them) will not be liable unless she "knows, or ought reasonably to know, that the other person would or would be likely to" trade or procure another to trade in the shares.

This partly parallels paragraph 34 of the ASX guidance note on continuous disclosure which provides that "confidential" has the sense of 'secret' and means that the information is in the possession of only those who will not trade in the entity's securities and there is control over the use of the information.[52]

The latter effectively amounts to an "embargo" under which those who have the information are contained in an embargo list and embargoed from releasing it or trading.[53]

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[45] Semann L, Freeman M and Adams M, 'Is Insider Trading a Necessary Evil for Efficient Markets? An International Comparative Analysis' (1999) 17 *C&SLJ 2*20 at 221.
[46] (2001) 51 NSWLR 548.
[47] Ibid. His Honour noted that the current Australian legislation arose out of a 1989 parliamentary committee report chaired by Alan Griffiths [House of Representatives Standing Committee on Constitutional and Legal Affairs, Parliament of Australia, Fair Shares for All: Insider Trading in Australia (1989)]. That review had noted various theories offered in support of the regulation of insider trading including:
(1) fairness, that is, market participants should have equal access to the relevant information from the company that issues the securities;
(2) fiduciary duty, that is, a person who holds a position of trust should not make a personal profit from that position without the informed consent of the beneficiaries;
(3) economic efficiency, that is, insider trading is damaging to the integrity of the financial market; and
(4) corporate injury, that is, insider trading injures the company which issued the securities, the shareholders in the company and investors who deal with insiders.
[48] *United States v. Chiarella*, 445 U.S. 222 (1980).
[49] *United States v. O'Hagan*, 521 U.S. 642 (1997).
[50] *Dirks v. SEC*, 463 U.S.646 (1983).
[51] Though it might be argued that equal access theory is about equal access by investors who trade rather than analysts who report to investors.
[52] See ASX Guidance Note No 8 on Continuous Disclosure issued on June 2005 paragraph 22.
[53] Though interestingly ASX has stated that it does not accept embargoes however this appears to be in the context of releases to the media on an embargoed basis rather than releases to others. ASX Guidance Note No 8 on Continuous Disclosure. Issued June 2005. Paragraph 22.

The tipper under the insider trading laws is likely to be able to rely on the fact of an embargo (assuming the tippee is on the embargo list) to show that he did not know or ought not reasonably to have known that the tippee would or would be likely to trade or procure another to trade. If there was no embargo a tipper would otherwise need to have some factual basis to negate the argument that the tipper ought reasonably to have known that the tippee would be likely to trade.[54]

It is arguable that the insider trading provisions thus shed light on the question of whether there can be selective disclosure to persons who are not "participants in the securities market" or "securities analysts."[55] This is because the insider trading provisions focus on the mischief that is to be remedied by those laws – namely trading by persons with inside information. Such persons obviously include participants in the market including securities analysts or their clients but it would be foolish to suggest that persons who may trade in shares are limited to those narrow groupings.

Admittedly the mischiefs that are to be remedied by continuous disclosure go beyond insider trading. As noted above they include a general objective to increase the amount of hard information in the market to promote capital market efficiency, to lessen the effect of rumour, to assist both secured and unsecured debt holders to monitor their positions and to improve managerial performance and accountability.[56] The laws followed the corporate collapses of the 1980s and when the bill was introduced into Parliament much was made of the need for investors to have confidence in the integrity of the market place and to make informed investment decisions.[57] Yet countering insider trading was also high on that list.[58]

The campaign against selective disclosure can thus be seen as being motivated by the dual goals of reducing opportunities for insider trading and promoting ordinary investors' confidence in the market as a level playing field. The question then is whether selective disclosure to certain other persons or entities is likely to run counter to these objectives. As will be seen it is quite likely that in some cases, such disclosures will do so. I will now focus on the question of selective disclosures to particular "non investors".

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[54] For instance the tipper might make a statement to the tippee that the information he has disclosed is inside information and the tippee should therefore not trade and the tippee might acknowledge this. If the tippee still traded however a question would arise about the timing of these conversations which take place ex post the communication of the information and therefore may not provide the tipper with a sufficient defence.

[55] Golding and Kalfus, above n 42 at 388.

[56] CASAC above n 2 p7

[57] Commonwealth, *Parliamentary Debates* (Hansard), House of Representatives, 15 December 1993, P4083 (Mr Lavarch, Attorney General).

[58] Ibid. In introducing the bill the Attorney noted:

> "*Timely disclosure of relevant information is essential for investors to have confidence in the integrity of the marketplace and to make informed investment decisions. This must be the central feature of an efficient and fair securities market. Full disclosure of information about the financial position and prospects of entities in which Australians invest helps to counter insider trading., the creation of false markets and the distortion of markets through rumours. In essence the capacity of a market to attract investment- and thus to enable continued economic growth- is directly linked to the confidence generated through timely disclosure of material information*".

Debenture-holders and selective disclosure

The 1994 report by CASAC[59] recommending an enhanced statutory disclosure system noted that enhanced disclosure would benefit a variety of users including existing and potential equity holders, existing and potential secured or unsecured creditors and existing and potential secured or unsecured debenture holders. As noted above the report also stated that such a scheme would assist debt holders in monitoring the performance of disclosing entities and thereby determine whether, or when, to exercise any right to withdraw or reinvest their loan funds, or convert debt to equity.[60] Though there were indications in 1992 that the proposed disclosure system would be directed toward investors rather than creditors[61] both the original bill and the eventual law, declared that debentures would also be considered enhanced disclosure (ED) securities in the situation where there was a trustee for debenture holders or the requirement of a trustee for debenture holders.[62]

Part of the schema of the modern *Corporations Act* is to provide various protections for the "consumers" of "financial services" and "financial products". Section 764A(1)(a) makes it clear that financial products include "securities" and both section 92 and section 761A make it clear that both shares and debentures are securities. Thus, in relation to the consumer protection focus of the *Corporations Act*, the distinction between debt and equity is quite blurred.[63] The protections can be seen to apply for the benefit of creditors as well as for the benefit of shareholders.[64]

The continuous disclosure requirements of section 674 apply to listed debenture securities in circumstances where the borrower company is obliged to appoint a trustee for debenture holders. This is because by section 111AI these are ED (enhanced disclosure) securities.[65] The trustee for debenture holders is a "consumer protection" measure.[66] A company issuing debentures is often required to appoint a trustee for debenture holders as a measure to protect those debenture holders (as set out in section 283AA) so that the continuous disclosure provisions will apply to many debenture holders.

Thus the disclosure obligations that require the disclosure of information that may affect the market price of securities also require disclosure of information that may

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59 CASAC above n2

60 Ibid p7.

61 Blair, above n 3 at 182.

62 Section 22F *Corporate Law Reform Bill (no 2*) 1992 (Cth)

63 The terminology whereby shareholders can become "consumers" of financial services or financial products provides something of a new slant on the stakeholder conception of the corporation where the corporation is constituted by owners, employees, suppliers/creditors and customers/consumers (see for instance Donaldson T. and Preston, L. E. "The Stakeholder Theory of the Corporation", *Academy of Management Review* 1995 Vol 20, No 1. 65-91). In this new conception the owners are seen as consumers of certain of the firm's products (ie its shares).

64 Thus the disclosure requirements on the initial issue of shares apply also to an initial issue of debentures. See section 706 Corporations Act.

65 "Securities" is defined under section 92 of the Corporations Act to include, inter alia, "debentures" of a body corporate. See also generally Harris, J and Hargovan A, Sons of Gwalia: Navigating the line between membership and creditor rights in corporate insolvencies (2007) *Company&Securites Law Journal* Vol 25 No 1.

66 Thus suppliers/creditors are also seen as "consumers" of the firm's financial services/products.

affect the market price of listed debentures (or "bonds" as they are sometimes known – particularly in the United States).

The market price of listed debentures will move up and down on secondary markets reflecting many of the same factors that affect the share price (principally the health of the company) but also reflecting other factors (the general level of interest rates and inflation rates and overall economic activity).[67] Thus the factors that may affect the market price of a debenture issued by a corporation are likely to include the factors that affect the share price of that corporation plus certain other factors.

Further, because of their traditional priority over equity in a liquidation (putting aside the possibility of parity shareholder claims arising from the decision in *Sons of Gwalia Ltd v Margaretic*[68]), the level of movement or elasticity of debenture prices will be less than share prices in response to a given price sensitive event.

Because of the nature of debentures and because of the way disclosure to debenture holders is regulated as set out above (ie in the same way as disclosure to shareholders) it seems unlikely that debenture holders would, in the ordinary lawful course of events, be given any preferential or selective information over shareholders. Debenture holders may however be in the same disadvantageous position as shareholders when it comes to the possibility of selective disclosure to a principal financier (which I will discuss shortly). If the latter occurred then there would appear to be a real issue about unequal treatment of creditors.

Unsecured creditors and selective disclosure

There is also the possibility of selective disclosure to an unsecured trade or other creditor. In the relationship between a company and, for instance, a major supplier, information might theoretically be disclosed to the latter to convince the supplier of the company's creditworthiness. This might for instance include recent revenues or future revenue projections that have not been announced publicly.[69]

Whether this would constitute selective disclosure would depend upon whether the information disclosed was material and not generally available. The two might interrelate in this example as whether it was material might depend upon the extent to which the information changes or alters current market perceptions of the company's future revenue position.

It would also depend upon whether the material was not required to be disclosed because it fell within the "carve-out" in 3.1 of the ASX Listing Rules (set out above). It might be arguable that future revenue projections comprised matters of supposition or were insufficiently definite to warrant disclosure within the meaning of clause 3.1A.3 (though even that might depend upon what present information the projections

[67] Australian Securities Exchange Publication, *Bonds and Hybrids* http://www.asx.com.au/markets/pdf/Bonds_Hybrids_2003.pdf viewed 19th October 2007
[68] (2007) 232 ALR 232; (2007) 81 ALJR 525
[69] Directors may also have an incentive to demonstrate these matters to a creditor to avoid any allegation of a lack of reasonable grounds to believe that the company would pay its debts. Such lack could of course expose the director to insolvent trading liability (see *Corporations Act* section 588J).

were based upon and the substantiality of that information).[70] It would be harder to apply this exception to the recent revenues. Assuming the exception in 3.1A.3 did apply it would also be necessary to show that the information was confidential and that a reasonable person would not expect the information to be disclosed. Whether the information was confidential might depend whether it was supplied on an expressly confidential basis and there was express agreement by the creditor not to trade in the company's securities.

This comes back to something close to the insider trading test in s1043A(2). Is the creditor likely to trade? Just because a person in one capacity is a creditor does not mean that they may not also decide to trade in the entity's shares.

Secured creditors and selective disclosure

As well as the possibility of giving a supplier information to convince the supplier of the company's creditworthiness there is clearly the possibility of a company giving such information to its financiers, particularly its major or primary ranking secured creditors. The relationship between a company and its principal financiers is inevitably close. A lender may require current information on the financial condition of a mortgagor company and this might include at least quarterly financial information if it is available.[71] In some cases where new finance is being arranged information may be disclosed outside a normal disclosure timeframe. A mortgagee bank has certain powers to deal with its interest in relation to land[72] (including a power to insure – though not in Victoria[73]) which may in some cases require provision of information. On default a mortgagee or chargee bank has even greater powers including rights of possession and sale.[74]

As noted, CASAC's report concluded that a statutory based system of continuous disclosure would benefit secured creditors in acting as a further, or substitute warning device for holders of charges over corporate assets, that breaches in covenants may have taken place, or the risk of default has increased.[75] This appears to implicitly accept that a company may already operate warning devices to its bankers – presumably through the disclosure of information.

In a paper reviewing the Australian experience of continuous disclosure the ASX has made it clear that companies have an obligation to go beyond their periodic disclosure requirements (which fall yearly and half yearly) and to disclose "information discovered in the course of preparation of structured disclosure documents" and not to defer disclosure until those structured documents are finalised[76].

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[70] They might also have been prepared for internal management purposes only within the meaning of 3.1A.3.
[71] Hinkel D, *Practical Real Estate Law*, 2003. P338. This information is more likely to be available in the US than Australia.because the former has quarterly reporting (see Golding and Kalfus above n p 42 at 2).
[72] Sykes, E.I. and Walker S, *The Law of Securities*, Fiftth Edition p271.
[73] Ibid. P 272. See also *Conveyancing Act 1919* (NSW) s109(5); *Law of Property Act* 1936 (SA) s47*: Conveyancing and Law of Property Act 1884* (Tas) s91.
[74] Ibid.
[75] CASAC above n 2.
[76] Australian Stock Exchange (ASX), "Continuous Disclosure – The Australian Experience" 20 February 2002 < http://www.asx.com.au/about/pdf/Continuousdisclosure-TheAustExperience.pdf>.

The relationship between the company and its bankers is likely to become even closer in a situation of financial difficulty for the company where the company may engage with its bankers in a "workout" (an agreement between the bank and the company to vary terms of the bank's security to prevent foreclosure).[77] His Honour Justice RP Austin, in a paper on accessory liability of banks and advisers, has noted that in a situation of financial difficulty which raises concerns about solvency, a company has three options.

> One possibility is, of course, to extend further credit in the hope that the existing management, with realistic business plans and tight financial controls, will be able to turn the situation round. That passive approach could be expensive for the bank, if management fails. The second possibility is for the bank to exercise its security, typically by appointing a receiver and manager. It is widely believed that the very act of imposing an external administration of this kind, with attendant publicity, will depress the value of the business and its assets and necessarily make it more difficult, and perhaps impossible, for a turnaround to be achieved. If the bank's exposure is well covered by the security, the bank may nevertheless choose to pursue this option, leaving other creditors to share the deficiency. But a bank may prefer to avoid this option where the exercise of the security will not recover 100 cents in the dollar or there are other reasons, for example reputation or public relations reasons, why the bank may not wish to be seen as "pulling the plug". It is the third alternative, engineering or supporting an informal workout outside the strictures of receivership, voluntary administration and liquidation, that is receiving very considerable attention at this stage in Australia's business cycle.[78]

His Honour (drawing no doubt on his experience in commercial cases and commercial law) also noted that a bank which becomes aware of a company's difficulties may investigate to ascertain the true position, form views about the problems and the means of rectifying them. It might do this itself through its own in-house specialists or it might engage an external adviser.[79] In either case, such an "investigation" is almost certain to put the mortgagee bank ahead of others in terms of disclosure unless the company disclosed the information to the market as the bank discovered it. The disclosure to the bank may itself be sufficient reason to strip the information of confidentiality unless it was done on an expressly confidential basis with express agreement not to trade, control over the use of the information and satisfaction of the other tests in Listing Rule 3.1A. If the carve out tests are not all satisfied then the "investigation" creates a risk of selective disclosure on the part of the company as it would seem unlikely that the company would be continuously disclosing information as the bank's investigators obtained it. It might also create a risk for the bank, because as Justice Austin has observed, the banker might become a person "involved" in any contravention by the company [within the meaning of section 674(2A)].[80]

The fact that the bank values the information being discovered by its investigators is arguable evidence of some price sensitivity and the fact that it is disclosed to the bank is arguable evidence that it has lost confidentiality (unless disclosed in the manner referred to above).

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[77] Hon Justice Robert P Austin., "Hip-Pocket Injuries in Workouts: Accessory Liability for Bankers and Advisers" (November 2006). Sydney Law School Research Paper No. 06/50 Available at SSRN: <http://ssrn.com/abstract=946316> viewed 20 February 2008 P2
[78] Ibid p2.
[79] Ibid p3.
[80] Ibid p 20.

Creditors of management

A further potentially difficult area for continuous disclosure is the issue of selective disclosure to those who are creditors not of the company, but of the directors or managers of the company. There has been a rise in the popularity of "margin lending" in recent years (especially during the boom share market conditions from 2002 to 2007) where banks and financiers have advanced funds for the purchase of shares on the security of those shares. This has seen managers, directors and other "insiders" acquire or purchase shares in companies that they are managing. Such arrangements suffer from all the traditional difficulties of managers who hold shares in companies (such as the fact that they frequently cannot trade due to the fact that they are in possession of inside information) as well as additional problems. The additional problems include the fact that if large shareholdings are held, the acquisition, sale, planned sale or likely sale of such a large shareholding might itself be a price sensitive event that should be disclosed by the company. [81] There are both specific and general (or arguable) requirements in this regard:

(a) there is a specific requirement that acquisition or disposal of a substantial holding (greater than 5 per cent of voting shares in the company) be disclosed by the shareholder to the company.[82] A variation in such a shareholding of 1 pent will also need to be disclosed to the company.[83] The provisions do not themselves specifically require notice to the market operator and, significantly, do not require advance notice.

(b) Under section 205G a director of a listed public company must notify the market operator of his (i) relevant interests[84] in securities of the company or a related body corporate and (ii) contracts that confer a right to call for or deliver shares, debentures or interests in a managed investment scheme made available by, the company or a related body corporate.

(c) Further, dealings, planned dealings or likely dealings in shareholdings smaller than this threshold may still need to be disclosed by the company to the ASX if such would be price sensitive within the general definition in section 674 or the Listing Rules. A company may not be aware of these matters if the director has not disclosed them to the company and the director may argue that he is not required to if the shareholding falls under the 5 per cent and 1 per cent thresholds mentioned above. On the other hand the knowledge of a director of such matters might be imputed to the company under section 1042G(1)(a) or under the organic theory of corporate responsibility.[85]

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[81] The issue was noted in the press following substantial director sales of shares in the company ABC Learning limited. See for instance Gettler L, "Experts cool on debt-level disclosure shake up" *Melbourne Age* 29th February 2008.

[82] *Corporations Act* Section 671B. A substantial holding means at least 5 per cent of voting shares (section 9 of the *Corporations Act*) and a variation means a movement of at least 1 per cent in their holding (see section 671B(1)(b) of the *Corporations Act*).

[83] Ibid

[84] Section 608 of the *Corporations Act* provides that a person has a relevant interest in securities if they: (a) are the holder of the securities; or (b) have power to exercise, or control the exercise of, a right to vote attached to the securities; or (c) have power to dispose of, or control the exercise of a power to dispose of, the securities

[85] See *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 at 713-714.

(d) There is the further general question of whether planned or likely sales purchases or imminent "margin calls"[86] need to be disclosed under s674(2). Whilst it might always be argued that a planned or likely dealing remains "an incomplete proposal" or "is insufficiently definite to warrant disclosure" (within the meaning of the carve out) the fact that a margin call will "kick in" at a particular price is clearly more tangible. Where the director has a large holding the sudden sale of that holding may impact the market price. Thus, under a margin call. Thus, if a reasonable person would expect the fact of an imminent margin call to have a material effect on the share price then arguably this needs to be disclosed. If there was such a requirement and it was a matter for advance notice then this would clearly be an obligation more onerous than that under section 671B referred to above as it appears to arise before the trade whereas the 671B obligation arises effectively after the trade.

(e) It is also relevant to note that, in a margin lending arrangement the obligation to disclose to the company set out in 671B is likely to apply to both shareholder and to the financier. This is because it is common practice that in some cases the financier will actually hold title to the shares or have an immediate right to obtain title.[87] Even if the financier does not hold title, the effect of section 608 of the *Corporations Act* is that the financier may have a "relevant interest" in the director's shares regardless of who holds the legal and who holds the equitable interest.[88] This is because the financier may have a power to dispose of or control the exercise of a power to dispose of the shares.

It follows that various difficulties can arise for both the director shareholder and the financier in these situations. Given the replicating nature of the continuous disclosure and insider trading provisions this may go beyond a disclosure issue for the company and may even touch on insider trading issues for both the director and his financier. If the fact of an imminent margin call satisfies the test for information that needs to be disclosed to the market it will also satisfy the test for being inside information so that a director who trades whilst in possession of same (before the information is disclosed or otherwise becomes public) may fall foul of the insider trading provisions (subject to the "own intention" defence in section 1043H).

Beyond that there is also an issue of potential liability for the financier. If the financier holds the legal title to the shares it is difficult to see how it can sell the shares or even cause another to sell the shares as this may fall foul of the insider

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[86] A "margin call" being a situation where the share price falls to the level where it no longer exceeds the contracted indebtedness and the financier demands either extra funds or sale of the shares. See "What is a margin call?" *Sydney Morning Herald* Business Section. <http://www.smh.com.au/business/money/tools/guides/investment/margincall.html> viewed 13 March 2008.

[87] Transcript of ABC Inside Business Report "Opes collapse fallout brutal for clients" dated 30/03/2008 Reporter: Alan Kohler. http://www.abc.net.au/insidebusiness/content/2007/s2202791.htm viewed 13 March 2008.

[88] The point was specifically made in guidance issued by ASIC on 6 March 2008. See ASIC Information Release IR 08-03 "Asic reminds market participants about stock lending disclosure obligations" Thursday 6 March 2008.http://www.asic.gov.au/asic/asic.nsf/byheadline/IR+08-03+ASIC+reminds+market+participants+about+stock+lending+disclosure+obligations?openDocument viewed 13 March 2008.

dealing or tipping/procuring offences.[89] Even if the financier does not hold the legal title there is the argument that it conveys price sensitive information (the fact that it is making a margin call and requires a sale) to the shareholder in the expectation that the latter will trade (thus falling foul of the tipping/procuring offences).

Against this it may be that the fact that the shareholder has the option of topping up his loan facility rather than selling the shares means that an "imminent margin call" is not price sensitive (as it is too uncertain). On the other hand the fact of shareholders and/or their financiers acting ahead of the market in share dealings and gaining a financial advantage thereby would appear to breach the equal access philosophy which historically appears to partly underpin both the continuous disclosure and insider trading laws.

"Those who will not trade"

As noted the carve-out in Listing Rule 3.1A applies to confidential information and 'confidential' in that context has the sense of 'secret'. It means that the information is in the possession of only those who will not trade in the entity's securities and there is control over the use of the information.[90] This definition may seem straight forward but it can become somewhat problematic when disclosure is made to a large corporate entity such as a bank or insurance company (see below). The problem here may be that the corporate entity does as a matter of ordinary business, trade in the securities of the entity. Though the personal representatives of the company who receive the disclosure may not trade, the entity itself, through other natural persons (who are not aware of the disclosure) may indeed trade.

This is the territory dealt with in the recent Federal Court decision of *Australian Securities and Investments Commission (ASIC) v Citigroup Global Markets Australia Pty Ltd (No 4)*[91]. That case involved proprietary trading by Citigroup in the shares of Patrick Corporation in a situation where Citigroup was advising Toll Holdings on a takeover bid for Patrick Corporation. It was found that at the time Citigroup traded in the Patrick shares it was aware that Citigroup was also acting for Toll in relation to its bid for Patrick and knew of the timing of the announcement of the proposed takeover bid. The latter information was known to Citigroup's CEO and others so that the knowledge was imputed to Citigroup under section 1042G(1)(a) (which imputes to a corporation knowledge of information that comes into possession of its officers in the ordinary course of business). The information was found to be not generally available and price sensitive however it was found that there were adequate "Chinese Wall" arrangements pursuant to section 1043F of the *Corporations Act*. Section 1043F provides:

> A body corporate does not contravene subsection 1043A(1) by entering into a transaction or agreement at any time merely because of information in the possession of an officer or employee of the body corporate if:

[89] Sections 1043A(1) and 1043A(2) respectively.
[90] ASX Guidance Note above n 32. Paragraph 34.
[91] (2007) 160 FCR 35; (2007) 241 ALR 705; (2007) 62 ACSR 427; (2007) 25 ACLC 940; [2007] FCA 963;

> (a) the decision to enter into the transaction or agreement was taken on its behalf by a person or persons other than that officer or employee; and
>
> (b) it had in operation at that time arrangements that could reasonably be expected to ensure that the information was not communicated to the person or persons who made the decision and that no advice with respect to the transaction or agreement was given to that person or any of those persons by a person in possession of the information; and
>
> (c) the information was not so communicated and no such advice was so given.

This defence however does not apply to the continuous disclosure provisions. On the other hand "those who will not trade" is a term from an ASX Guidance Note to the interpretation of Listing Rules so it has no legislative force (though the Listing Rules themselves are given implied legislative force through s 674). On its face then the Chinese Wall structure is not necessarily available in the context of the continuous disclosure provisions to argue that information given to a banker or insurer is confidential and in possession of "those who will not trade"within the meaning of the ASX guidance note on continuous disclosure. On the other hand a confidentiality agreement or non trading agreement may be signed by a banker or insurer in these circumstances.

Others who may receive selective disclosure

The problem of selective disclosure is not limited to possible selective disclosure to creditors. There are other groups of persons including insurers, employees, regulators, takeover bidders and various other parties who deal with the corporate entity and may receive information that has not been announced to the market. I will discuss each in turn.

Takeover bidders

The issue of takeover bidders receiving selective disclosure has been considered by Australia's Takeovers Panel. In a Guidance Note issued on 7 June 2007 the Panel noted the situation of involvement or potential involvement by the management, directors or external advisers of a target company with a bidder in a takeover bid or potential bid for the target company.[92] The Panel recognised, inter alia, that there was a need for any disclosure of target company confidential information to the bidder or potential bidder to be subject to appropriate controls.

The Panel ultimately concluded that, as a general principle, the target company should seek to ensure that a bidder who is involved with participating insiders (such as management, directors or external advisers of the target) did not have an information advantage over shareholders (including an information advantage in relation to forward looking information). For example, a target should carefully compare the level and detail of information which was provided to the bidder against the level of information disclosed in the Target statement issued under section 638.[93] This

[92] Takeovers Panel Guidance Note 19: "Insider Participation in Control Transactions" Issued for comment on 21 February 2007 <http://www.takeovers.gov.au/display.asp?ContentID=1188>.
[93] Ibid.

conclusion tends to support the view that there are no exceptions to selective disclosure. Admittedly of course the bidder's status is very much that of an investor and/or potential investor in the company's shares so that disclosure to a bidder is clearly of more moment than to those who are not likely to trade.

Employees

The ASX Guidance Note on continuous disclosure notes at paragraph 38 that employees who have access to information that is not public should be made aware of its confidential status and the importance of maintaining that status.[94] Obviously they would need to be told that they should not trade in the entity's shares. Disclosure to employees in the ordinary course of events is unlikely to constitute selective disclosure given that employees can be seen as part of the corporate entity itself.[95]

Insurers

Insurers may be in a position to receive selective disclosure. Insureds are under a duty of utmost good faith (as are insurers to their insureds). This duty would require that a company, at the time of entering into the insurance contract, disclose to its insurer all material facts relevant to the policy and risk under that policy.[96] In the context of product liability insurance this might require the insured corporation to disclose to its insurer a possible liability in relation to products provided by the company even though no harm has ever actually materialised. The company might have received advice for instance that the risk of any harm occurring is negligible, that the harm, if it ever occurred was not the fault of the company but the fault of another but that there was still some slight risk. This would need to be disclosed to the insurer. It is arguable about how material such information might normally be – it may be that the test of materiality is a lower standard than the test of utmost good faith. On the other hand, the disclosure to the insurer might itself suggest some materiality and the question then is whether the information was confidential. This question then would be determined on whether the information fell into the carve-outs in Listing Rule 3.1A. It might be that such information was prepared for internal management. It might also be that it would be a breach of law to disclose the information as it may be in breach of contract with the insurer. Depending upon the nature of the information there may be potential for it to be used against as an admission by plaintiffs against the insurer's interests in a civil suit).

Regulators

As noted, the ASX Guidance Note No 8 on Continuous Disclosure provides that:

> ASX accepts that confidentiality is not lost simply because information is given to an entity's advisers, a person with whom the entity is negotiating, or regulatory authorities, if it is to be given on a basis that restricts its use to the stated purpose. However any release of the information from any source, however inadvertent, will mean that listing rule 3.1A.2 is no longer satisfied."[97]

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[94] ASX Guidance Note above n 32 at para 38.
[95] On the other hand the ASX Listing Rule 19.2 limits "awareness" to awareness by a director or executive officer.
[96] See generally Sutton K, *Insurance Law in Australia* Law Book Company Third Edition 1999.p159
[97] ASX Guidance Note above n 32 at para 37.

Of all the forms of disclosure discussed, the disclosure to a regulatory authority would seem to be the least likely to constitute selective disclosure given the usual confidentiality obligations of regulators. [98] Nevertheless if the information is price sensitive and not generally available it will also need to be disclosed to ASX unless the carve out is fully satisfied.

LISTING RULES AND SELECTIVE DISCLOSURE IN OVERSEAS JURISDICTIONS

Similar issues in relation to possible selective disclosure and confidentiality can be seen to arise in overseas jurisdictions however prohibited selective disclosure appears to have been identified more precisely and dealt with more specifically, particularly in the United States.

United Kingdom

In the United Kingdom the UK Financial Services Authority (FSA) reviewed its Listing Regime in 2005 to incorporate the European Market Abuse Directive within the FSA Handbook.[99] The Market Abuse Directive was part of the European Union's Financial Services Action Plan adopted by the European Council on 2 December 2003.[100] It sought to set a common framework for tackling insider dealing and market manipulation in the EU and for the proper disclosure of information to the market.[101] Meanwhile continuing obligations in relation to disclosure were incorporated in a separate section of the FSA handbook - the 'Disclosure Rules', (DRs). The latter became in 2007 the 'Disclosure and Transparency Rules' (DTRs).[102]

In general the DTRs require notification to the relevant regulatory information service of any inside information (DTR2.2.1) concerning the issuer.

In relation to the issue of possible selective disclosure, Rule 2.2.10 of the Disclosure and Transparency Rules notes that:

> The FSA is aware that many issuers provide unpublished information to third parties such as analysts, employees, credit rating agencies, finance providers and major shareholders, often in response to queries from such parties. The fact that information is unpublished does not in itself make it inside information. However unpublished information which amounts to inside information is only permitted to be disclosed in accordance with the disclosure rules…[103]

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[98] For instance s127 of the *Australian Securities and Investments Commission Act 2001(Cth)*
[99] Knight M, (Manager Company Monitoring, Financial Services Authority City) Speech on the FSA's Continuing Obligations Regime 21 November 2007 <http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/1121_mk.shtml> viewed 28 February 2008.
[100] 2003/6/EC.
[101] HM Treasury "UK Implementation of the EU Market Abuse Directive 2003/6/EC" 18 June 2004 http://www.hm-treasury.gov.uk/consultations_and_legislation/market_abuse_directive/consult_market_index.cfm viewed 28 February 2008.
[102] Knight above n 99
[103] FSA Handbook , Disclosure and Transparency Rules (DTR) 2.2.10.

This maintains a certain unhelpfulness in effectively noting that unpublished information is not necessarily inside information unless it is inside information.

United States

In the United States the legislative requirement is for periodic (quarterly) rather than continuous disclosure.[104] On the other hand the rules of the New York Stock Exchange do require "timely" disclosure. Listing Rule 202.05 provides:

> "A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange. A listed company should also act promptly to dispel unfounded rumours which result in unusual market activity or price variations"[105]

Further, the SEC implemented Regulation FD (Fair Disclosure) in October 2000 to deal with selective disclosure. The General Rule 100 of Regulation FD provides:

(a) Whenever an issuer, or any person acting on its behalf, discloses any material non public information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in Rule 101(e):
1. Simultaneously, in the case of an intentional disclosure; and
2. Promptly, in the case of a non-intentional disclosure.

The persons referred to in Rule 100(b)(1) to whom disclosure is not to be made unless accompanied by public disclosure are:
(i) broker-dealers and their associated persons;
(ii) investment advisers, certain institutional investment managers and their associated persons;
(iii) investment companies, hedge funds and affiliated persons;
(iv) shareholders who it is reasonably foreseeable may trade.

In promulgating Regulation FD in this form the SEC noted that it had been submitted to it by various commenters that if Regulation FD applied to disclosures made to "any person" outside the issuer, it would inappropriately interfere with ordinary-course business communications with parties such as customers, suppliers, strategic partners, and government regulators.[106] It had also been submitted by media organizations and rating agencies that the regulation should not apply to disclosures made to the press, or to rating agencies for purposes of securities ratings. In response to these comments, the SEC stated that it had narrowed the coverage of the final regulation and focused on the core problem of selective disclosure made to those who would reasonably be expected to trade securities on the basis of the information or provide others with advice about securities trading. Accordingly, Rule 100(a) of Regulation FD, as adopted, made it clear that the general rule against selective disclosure applied only to disclosures made to the categories of persons enumerated in Rule 100(b)(1).

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[104] See generally Cassidy A and Chapple L, "Australia's corporate disclosure regime; Lessons from the US model" (2003) 15 *AJCL* 81.
[105] New York Stock Exchange Listing Rule 202.05
[106] Securities and Exchange Commission, "Final Rule: Selective Disclosure and Insider Trading", 17 CFR Parts 240, 243 and 249 Release Nos 33-7881, 34-43154, IC-24599, File No. S7-31-99

Further, by Rule 100(b)(2) the enumerated persons would not include persons owing a duty of trust or confidence (said to include an investment banker) or a person who agrees to maintain the disclosed information in confidence (as well as certain other entities).

The US law therefore appears to maintain the confidentiality exception that exists in Australian law. It is different to Australian law however in its view that selective disclosure is more of an evil when it is disclosure to persons in the investment community or persons who may trade in the entity's shares rather than disclosure to others for other purposes. On the other hand the Australian continuous disclosure laws are wider in their intent than being merely about disclosure to investors. They are also about disclosure to creditors which may include debenture holders and others.

Interestingly the United States regulation FD was considered in the 2005 US Federal Court ruling in *SEC v Siebel Systems*[107] and the court found in favour of the disclosing entity. The facts of that case involved a private meeting between the Chief Financial Officer of Siebel and institutional investors where the former allegedly made positive comments about Siebel's business activity levels which contrasted with negative public statements made in the preceding several weeks. The court found in favour of Siebel and against the SEC noting that the comments were not material non public information as similar comments had already been made publicly. The court was also critical of the SEC's "heightened" scrutiny of "particular words used in the statement, including the tense of words and the general syntax of each sentence."[108] It indicated that this "placed an unreasonable burden on a company's management and spokespersons to become linguistic experts or otherwise to live in fear of violating regulation FD should the words they use later be interpreted by the SEC as connoting even the slightest variance from the company's public statements."[109] It has been noted that for some two years after that decision the SEC did not bring, settle or contest a single FD enforcement case.[110]

CONCLUSION

Implicit in the Australian law of continuous disclosure is the notion that price sensitive material that is not generally available should be disclosed promptly to the market as a whole rather than to just some of the market. This is achieved through disclosure to the Australian Securities Exchange (ASX) which posts the information on its website to make it immediately available. The problem of selective disclosure has been identified as a disclosure to a segment of the market (such as analysts) rather than the market as a whole. In everyday commerce a corporation has close relationships with a number of other persons who may seek information from the company for various reasons connected with their relationship. These include financiers, suppliers, employees, insurers and regulators. Despite a close relationship of trust it seems that a disclosure of information to any of these entities that goes

[107] *SEC v Siebel Systems Inc*.,_F.Supp.2d_,No 04CV5130 (GBD), 2005 WL 2100269 (S>D>N>Y> Sept 1 2005).
[108] Ibid at 8.
[109] Ibid.
[110] Morgan N, "The Rise, Fall (and Return?) of Reg FD" *Forbes.com*. 14 August 2007. See http://www.forbes.com/2007/08/13/reg-fd-sec-oped-cx_nmo_0814regfd.html

beyond what has been disclosed to the market as a whole may constitute an instance of selective disclosure if the information is material, and not generally available. In its defence a company might argue that the information is confidential. To do so it will need to establish that those entities will not trade. It will also need to show that the information falls within at least one of the exceptions set out in listing rule 3.1A. If it does not then disclosure to some of these entities will need to be accompanied by simultaneous disclosure to ASX. If this does not occur then companies may find themselves in breach of section 674.