

[To be typed on Business Law Section letterhead]

John Kluver,  
Executive Director,  
Companies & Securities Advisory Committee,  
GPO Box 3967,  
Sydney, NSW 2001.

15 November 2001

Dear John,

### **Insider Trading Discussion Paper**

I enclose a submission prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia in response to your Insider Trading Discussion Paper.

The Committee believes that it is very timely for Australia's insider trading regime to be subject to a comprehensive review. As your Discussion Paper notes, Australia adopted its own unique approach to the regulation of insider trading 10 years ago and the Committee believes it is now appropriate to review this approach in light of both our own experience and international developments in the intervening period. This is so even though our insider trading rules were recently rewritten by the Financial Services Reform Act because the new provisions were not exposed for comment as part of the original FSR Bill and attracted little public attention when they were finally introduced into Parliament.

Against this background, the Committee congratulates CASAC for the work it has undertaken in preparing its Discussion Paper. The Discussion Paper is very comprehensive and thoughtful document. It also identifies very clearly the key issues which need to be considered in any review of insider trading and provides a very good basis for a discussing the competing considerations which shape the law in this area.

The Committee has prepared the enclosed submission in response to the 40 issues identified in the Discussion Paper. As you will see, the Committee agrees with some of the provisional views expressed by CASAC, but disagrees with others. In particular, the Committee believes that the rationale for insider trading regulation should be more narrowly defined – focusing more on the misuse of privileged information than the mere use of information that is not generally available - and that this should shape the framework of the prohibition. The Committee also sees some merit in the adoption of different civil and criminal regimes along the lines of the recent UK reforms.

*Corporations Committee*  
*15 November 2001*

We trust the enclosed submission assist CASAC in its deliberations. In addition, if you would find it useful, members of the Committee would be happy to meet with you to discuss aspects of the submission in more detail.

Yours sincerely,

## **Insider Trading**

### **Discussion Paper**

**June 2001**

#### **Submission by the Corporations Committee, Business Law Section, Law Council of Australia**

**Issue 1: Are the current market fairness and market efficiency rationales for the Australia insider trading legislation appropriate?**

The Committee agrees that “identifying the reasons for prohibiting insider trading is fundamental to the appropriate development and application of insider trading laws”.

The Issues Paper identifies four main rationales that have been put forward from time to time:

- fiduciary duty
- misappropriation
- market fairness
- market efficiency.

In general, the Committee supports CASAC’s view that the market fairness and market efficiency rationales are more appropriate because they focus on the broader market implications of insider trading and its economic repercussions. However, the Committee does not believe that market fairness or market efficiency require a strict “disclose or abstain” rule that prohibits any person in possession of material, non-public information from dealing in securities.

As the Issues Paper acknowledged, no financial market other than Australia (and Malaysia) has such a rule and it is difficult to believe that there are unique features of the Australian (and Malaysian) markets which require a regime which is fundamentally different from those operating everywhere else. It is also difficult to believe that “investor confidence” requires such a different regime if that requirement has not been manifested in New York, London, Tokyo, Frankfurt, Paris, Hong Kong or any other major financial market.<sup>1</sup>

While the report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, “Fair Shares For All: Insider Trading in

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<sup>1</sup> We acknowledge that the Proposal for a Directive of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) presented by the Commission of the European Communities earlier this year adopts a similar approach to the Australian regime. However, this has not met with universal acclaim and, until such time as it becomes clear that the proposed approach will be reflected in a final directive, we do not believe this should carry much weight.

Australia” (“Fair Shares For All”) clearly stated that the basis for the Australian prohibition on insider trading should be the need to guarantee investor confidence, the Committee is of the view that “Fair Shares For All” does not provide a sufficient justification for a “disclose or abstain” rule when that rule has been rejected in every other leading financial market.

In these circumstances, the Committee believes that any revised insider trading legislation in Australia should reflect a more careful balancing of the conflicting factors that need to be taken in to consideration in this area. These were clearly stated in the United Kingdom when the Financial Services Authority (“FSA”) issued its initial consultation draft Code of Market Conduct in 1998 (CP10 “Market Abuse. Part 1: Consultation on a draft Code of Market Conduct). This explicitly recognised that:

“there will always be times where certain persons will have access to relevant information that is not available to others. Such persons may have an opportunity to take advantage of that information by trading on the basis of it, thereby realising a profit or avoiding a loss. Although the person may therefore have benefited, it is not necessarily against the wider interest of the market that he does so. Where the benefit is taken through a trade the market will reflect that person’s sentiments and hence indirectly the information. In all markets, a balance has to be struck between often conflicting factors: the desire to bring all information to bear upon the price, through trading and disclosures; the need to reward properly those who research or analyse; and the damage that can be done to efficient pricing if people fear those with whom they are trading have some informational advantage over them.” (see paragraph 74)

The Committee wishes to emphasis that, in balancing these considerations, it does not support the arguments of Professor Henry Manne in defence of trading by corporate insiders on the basis of their privileged access to information<sup>2</sup>. The Committee accepts that such trading undermines investor confidence in the fairness of financial market and that this outweighs any arguments that such trading enhances market efficiency. However, the Committee does not believe that investor confidence is harmed by all trading undertaken by people who have information that is not generally available. Indeed, to the contrary, it believes the market expects and benefits from such trading, which fulfils one of the primary functions of any market – namely price discovery – and contributes to overall market efficiency.

In the Committee’s view an appropriate balance of these considerations is now reflected in the final version of the UK Code of Market Conduct (“FSA Code”), which provides that misuse of information will only amount to market abuse if all four of the following circumstances are present:

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<sup>2</sup> Manne “Insider Trading and the Stock Market” (1966).

- a person deals or arranges deals in any qualifying investment or product based on information;
- the information is not generally available;
- the information is likely to be regarded by a regular user as relevant when deciding the terms on which transactions in the investments of the kind in question should be effected; and
- **the information relates to matters which the regular user would reasonably expect to be disclosed to users of the particular prescribed market. (see paragraph 1.4.4)**

The fourth of these conditions makes it clear that the essence of the abuse is the misuse of privileged information rather than merely trading on the basis of an informational advantage. Other jurisdictions adopt a very similar approach by incorporating a “person connection” test into their laws (as discussed in relation to Issue 4 below).

The Committee’s comments on the “person connection” test are set out in more detail below. However, the Committee recommends that any stated rationale for revised legislation explicitly recognises that an essential element of insider trading is the misuse of privileged information and not merely the possession of price sensitive information.

In this context, the Committee also recommends that CASAC give consideration to the possibility of establishing different regimes for criminal and civil liability in this area. In the United Kingdom, criminal laws apply only to a relatively narrow range of very serious misconduct where there is a clear intention to abuse the market and other users. However, the civil regime covers a much broader range of misconduct which may adversely affect market confidence, integrity and efficiency. The civil regime also provides for the FSA to issue a code giving appropriate guidance as to the behaviour which may be regarded as constituting “market abuse”.

While it is too early to judge the United Kingdom’s experience with this regime, it does appear to offer a number of significant benefits:

- the definition of “market abuse” in the civil regime can be framed in more general terms than would be appropriate in a provision giving rise to criminal liability;
- the code of market conduct allows the regulator to give more specific guidance in relation to specific practices than is possible in legislation;
- the code is also more flexible and can be adapted to suit changing market practices and different expectations in different markets; and
- the criminal regime can be confined more narrowly to serious and intentional misconduct without condoning abusive practices

Clearly, the adoption of a similar regime in Australia would require extensive market consultation. Nevertheless, if there is to be a reform of the law in this area, the Committee believes that the adoption of a similar regime would merit serious consideration.

**Issue 2: Is the current Australian broad approach to the definition of inside information appropriate? Should the legislation exclude information that relates only to securities generally or to issuers of securities generally?**

The Committee believes that the current Australian broad approach to the definition of inside information is appropriate. However, the Committee believes it would be helpful to exclude information that relates only to securities generally or to issuers of securities generally. The Committee also believes that safe harbours should be established to permit trading on the basis of certain trading information.

The Committee notes the suggestion in paragraph 1.40 of the Issues Paper that information in relation to trading activities and the operation of markets may constitute price sensitive information under current Australian law.

In this regard, it is notable that FSA Code has specific safe harbours which permit trading on the basis of such information (see paragraphs 1.4.26 and 1.4.28). While authorised firms may have other regulatory or legal obligations governing behaviour such as “front-running”, the FSA explicitly recognised that:

“while trading information will be unavailable to other market users and may also be relevant in deciding the terms in which transactions should be effected, behaviour based on this information is not regarded as amounting to market abuse. Other users of the market would not expect to have equal access to such information, and behaviour based on this information would not constitute a failure to observe the standard of behaviour reasonably expected by a regular user” [FSA 59 “Market Abuse: A Draft Code of Market Conduct”, paragraph 6.50].

After public consultation, the safe harbours proposed in FSA59 were further widened.

The Committee believes that similar safe harbours should be established in Australia.

The Committee also notes the commentary in paragraph 1.41 of the Issues Paper in relation to the issues which arose in the case of *R v Evans and Doyle* [1999] VSC 488. The Committee believes these issues are more appropriately dealt with in the context of Issue 4, but doubts whether “regular users” in Australia would have expected the information allegedly

possessed by Mr Evans in that case to have been disclosed to the market. Accordingly, it does not believe that Australian law should prohibit a person trading while in possession of such information.

**Issue 3: Should the current Australian definition of insider, which includes entities as well as natural persons, be maintained or be confined to natural persons?**

The Committee supports the current Australian definition of insider, which includes entities as well as natural persons if, but only if, an appropriate Chinese wall defence remains in place. (refer to Issue 27)

The Committee notes that under current Australian law a body corporate may be guilty of an offence if it deals in securities when an officer of the body corporate possesses price sensitive information even though that information has not been communicated to the persons who made the decision to deal. The defence under Section 1002M may not be available even though paragraphs 1002M(a) and (c) are both satisfied if the body corporate's "chinese wall" does not satisfy paragraph 1002M (b). This seems an unjust situation and one which would be avoided if the law only applied to natural persons. The extension of the law to bodies corporate complicates the law by requiring rules dealing with the attribution of knowledge to a corporate entity and the availability of "chinese wall" defences.

If Australia were to adopt differentiated criminal and civil regimes along the lines discussed under Issue 1, the Committee would support the criminal offence being confined to natural persons to avoid these complications.

In any event, the Committee does not agree that limiting the legislation to natural persons would undermine incentives for entities to control the flow of information within their organisations (cf paragraph 1.55 of the Issues Paper). The natural persons in charge of an entity's affairs would continue to have very strong incentives to implement such controls. This is clearly evident from the experience in the United Kingdom.

The Committee comments on the topic raised in paragraph 1.60 in the context of Issue 14.

**Issue 4: Should the Australian definition of insider continue to take an "information connection" approach only or require an additional "person connection" element?**

The Committee does not believe that the Australian definition of insider should continue to take an "information connection" approach only. While we do not advocate a return to an approach which requires a formal "person connection" element, we do support a modified approach which

recognizes that insider trading is characterised by the misuse of privileged information rather than merely the use of information which may not be available to the market as a whole.

As the Issue Paper notes, Malaysia is the only other jurisdiction in the world which has a criminal offence of insider trading without a “person connection” requirement. While the UK civil regime governing market abuse does not have a specific “person connection” requirement it is much closer to the rest of the world than Australia. Indeed, the FSA Code reflects many features of the US fiduciary duty and misappropriation rules.

While it is always possible that there are unique features of the Australian markets which require a different regime from the rest of the world, the Committee believes a fundamentally different regime should only be retained if a strong and convincing rationale is put forward for so doing. The Committee does not agree with the comments in paragraph 1.73 of the Issues Paper that “market fairness and efficiency” require this result. In the Committee’s view, these comments give insufficient weight to the points noted in paragraphs 1.20 – 1.22 of the Issues Paper that recognise the market does not expect all informational advantages to be eliminated.

While “Fair Shares for All” clearly concluded that Australia’s previous “person connection” test was too restrictive, it also concluded that “the offence of insider trading must have its genesis in the use of information derived from within a company” (see paragraph 4.3.5). This was consistent with the arguments of the National Companies and Securities Commission and the Committee of Inquiry into the Australian Financial System, which were cited with approval in paragraphs 3.1.10 and 3.3.6. At no point does “Fair Shares for All” provide a clear or cogent rationale for extending the insider trading prohibition to people who are not “insiders” and do not have “inside information”. If the prohibition is to continue to be so extended, the Committee believes such a clear and cogent rationale is required. That rationale should also squarely address the countervailing arguments that have been accepted in all other major financial markets.

The Committee recognises that the “person connection” approach is less straightforward than the “information connection” only approach. The Committee also recognises that the “person connection” test found in the laws of many jurisdictions (and previous Australian law) may be too narrow to capture every circumstance in which a person may possess privileged information that the market would expect to be disclosed before any dealing. The Committee believes this is a further argument for adopting the UK approach in which the criminal offence is more narrowly defined (with a formal “person connection” test) whilst the civil regime has a more flexible approach that is guided by a regulatory code of conduct.

**Issue 5: Should the insider trading legislation:**



- **prohibit any person holding inside information from disclosing that information without a lawful reason, even where the purpose or result of the disclosure is that the recipient does not trade;**

The Committee notes that the FSA Code (which is referred to in the Issues Paper as an example of such a prohibition) does not “prohibit” disclosure of inside information without a lawful reason, but rather provides guidance as to the circumstances in which selective disclosure of such information may be regarded as “encouraging” another person to deal. The FSA Code also lists an extensive range of circumstances in which such disclosure will not be regarded as encouraging others to deal (see paragraphs 1.8.6 and 1.8.7 of the FSA Code). Notably, these provisions are identified as “examples of disclosure for a legitimate purpose” and are not stated to be exhaustive. The Committee would support similar provisions in a similar code in Australia, but opposes any such prohibition being introduced in to Australia’s insider trading legislation.

- **require a person lawfully disclosing inside information to inform the recipient that the information is inside information;**

Once again, the relevant provision in the FSA Code forms part of the guidance as to whether selective disclosure may be regarded as encouraging another person to deal. The Committee would again support a similar prohibition in a similar Code but opposes any such requirement being introduced into Australia’s insider trading legislation.

- **impose liability on persons holding inside information if they “discourage or stop” another person from dealing in affected securities?**

The Committee believes that insider trading legislation should not impose liability on persons if they discourage or stop another person from dealing in affected securities.

Most companies which have policies restricting trading in their securities by directors or officers typically seek to extend those policies to relatives, family trusts and similar entities. Clearly, the law should not prohibit a director from discouraging or stopping their spouse from buying securities when the director is in possession of favourable information (or selling securities when the director is in possession of unfavourable information).

While current law leaves open the possibility that a director may discourage their spouse from buying securities when the director is in possession of unfavourable information (or selling securities when the director is in possession of favourable information), this

has limited adverse effects on the market. It would also be very difficult to identify such non-trading or to bring any meaningful enforcement action. In these circumstances, the Committee believes that the insider trading legislation should not impose liability in these circumstances.

**Issue 6: Should the test of generally available information:**

- **give priority to the publishable information test;**
- **expand the application of that test; or**
- **extend the circumstances where a reasonable dissemination period is required under that test?**

The Committee does not believe that the test of generally available information should:

- give priority to the publishable information test;
- expand the application of that test; or
- extend the circumstances where a reasonable dissemination period is required under that test.

The Committee believes that the framework it has proposed in relation to Issues 1 and 4 would provide a more coherent basis for dealing with the issues.

It may well be inappropriate for a corporate officer (or other connected person) to be prohibited from trading (or from encouraging others to trade) on the basis of privileged information they have gained in relation to a material decision of a foreign court which affects their company and has not been disclosed to the market. However, the Committee does not believe it would be appropriate to prohibit an analyst from providing a recommendation based upon their diligence and effort in monitoring such a decision ahead of an announcement. Unless the prohibition incorporates a “person connection” test, the analyst in such a circumstance would be treated as an “informed person” who could not avail themselves of the defence in section 1002T (2) (a).

The Committee believes that Australian law should encourage people to use information they have obtained by research, analysis or other legitimate means. The proposals in the Issues Paper would stifle legitimate research and analysis and harm Australia’s financial markets.

**Issue 7: Should the readily observable matter test be clarified? If so, in what manner?**

The readily observable matter test should be clarified. In line with the FSA Code, information should be regarded as readily observable:

- if it is discussed in a public area or can be observed by the public without infringing rights of privacy, property or confidentiality;
- even if other users of the market cannot obtain it because of limitations on their resources, expertise or competence;
- even if it is only available overseas; and
- even if it is only available on payment of a fee.

**Issue 8: Should the Australian legislation require that inside information must be specific or precise?**

No.

The FSA Code does **not** “require inside information to be specific or precise”. Rather, the “extent to which... information is specific or precise” is one of many factors to be considered in determining whether information is “relevant information” (see paragraphs 1.4.9 – 1.4.11). All of these factors would be useful and relevant if a similar code were adopted in Australia.

**Issue 9: Do the current insider trading and continuous disclosure provisions properly complement each other?**

The Committee supports the continuation of existing exemptions from the continuous disclosure requirements and agrees that the insider trading provisions should continue to apply to price sensitive information that falls within these exemptions.

**Issue 10: What, if any, amendments are necessary to take into account research and analysis?**

The committee refers to its comments in response to Issues 1, 4, 6 and 7.

While the Committee does not support the approach adopted in *Dirks v SEC* 463 US 646 (1983), it notes that the activities of the analyst in that case were crucial in uncovering and exposing an infamous corporate fraud. The analyst initially reported that fraud to the company’s auditors and sought to have it reported in the press, but they declined to act. Others reported it to regulators (including the SEC) who also failed to act. It was only when the analyst discussed his findings with his clients and their selling prompted a fall in the share price that regulators acted and uncovered the fraud.

This clearly demonstrates the beneficial effects of research and analysis, which will be lost if the insider trading prohibition is too restrictive.

The Committee accepts that analysts must not be freely allowed to trade or publish research on the basis of inside information sourced from corporate management. However, the law should not deter analysts from questioning corporate managers or from publishing research which is not based on privileged information.

**Issue 11: What, if any, amendments are necessary to take into account trading before release of one's own research?**

The Committee believes this issue is better dealt with by requiring full disclosure of any such trading.

Analysts are invariably involved in providing advice to clients on an ongoing basis, while research reports are published only at intervals (and, even then, are not usually made generally available). Consequently, there will always be circumstances in which some people will be dealing on the basis of an analyst's views when others do not have access to those views. This is inevitable and unobjectionable. If an analyst engages in "pump and dump" or other objectionable conduct, this is more appropriately dealt with as market manipulation.

**Issue 12: Should the range of financial products covered by the insider trading provisions of the Financial Services Reform Bill exclude indices, derivatives over commodities and/or any other financial products?**

The Committee notes that the Financial Services Reform Act has now been enacted in terms which will extend the new insider trading prohibitions to "Division 3 financial products", including derivatives and other financial products that are able to be traded on a financial market.

The Committee shares the concerns noted in paragraphs 2.88 to 2.92 of the Issues Paper that the extension of the insider trading prohibition (as currently framed) to derivatives over commodities could unduly restrict the ability of people who deal in the underlying commodities (and may, as a consequence, have price sensitive information in relation to those commodities) in engaging in derivative transactions. Most commodity producers engage in hedging strategies using derivatives and we believe that it is undesirable to prevent them from doing so simply because the information they have gained from participation in the commodity market may be price sensitive in the derivative market. We do not believe that derivatives should be subject to a different regime from the underlying commodity.

We note the suggestion that one way of dealing with this issue would be to allow commodity producers to hedge physical positions but to prohibit overhedging or profit taking. However, we believe this would an extremely difficult distinction to make in practice because hedging

strategies are often complex and involve a range of different derivatives that may not be precisely matched against physical positions even when the primary aim is to hedge underlying exposures in the physical market.

If the primary insider trading prohibition were recast along the lines suggested earlier in this submission, these problems may well be less acute. Derivative trading by a commodity producer on the basis of its knowledge of the physical market would, we suggest, not be regarded as involving the misuse of privileged information. In contrast, the example given in paragraph 2.90 of the Issues Paper of an executive of a mining company who takes a short position in gold futures contracts on the basis of confidential information about the discovery of a large gold deposit by that company almost certainly would involve the misuse of privileged information. This highlights the difficulties which flow from the failure to refine the primary definition of what constitutes insider trading.

**Issue 13: Should the insider trading legislation apply to any trading or only transactions that are or can be carried out on a public market?**

The Committee believes that the insider trading legislation should be confined to public markets<sup>3</sup>.

In the Committee's view, people who transact in private markets do not expect to have equivalent access to information. This is reflected in the lack of any continuous disclosure regime. Typically, they rely on contractual representations and warranties instead.

The Committee believes it is anomalous that insider trading laws might apply when a major company sells securities in a private subsidiary to another major company (especially if the disclosures regarding the subsidiary are negotiated at arm's length).

**Issue 14: What, if any, amendments are needed to enable companies to issue their own securities without breaching the insider trading provisions, while properly protecting investors?**

The Committee believes that a company's disclosure obligations in relation to an issue of securities should be regulated by prospectus laws and not insider trading laws. For example, a listed company should be free to make a placement without needing to disclose information that has been exempted from disclosure under the continuous disclosure regime.

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<sup>3</sup> It may be appropriate to treat all ED securities as being subject to the insider trading regime and not limit the regime to quoted securities.

**Issue 15: What, if any, amendments are needed to enable companies to buy back their own securities without breaching the insider trading provisions?**

Likewise, the Committee believes this subject should be regulated by share buy-back laws and not the insider trading legislation.

**Issue 16: What, if any, amendments are needed to enable informed persons (that is, persons who only receive inside information in the period between entry into and exercise of an option contract) to exercise their physical delivery option rights without breaching the insider trading provisions?**

Generally speaking, the Committee believes that people should be free to exercise contractual rights or perform contractual obligations if they acquire those rights (or assume those obligations) without breaking the insider trading laws. However, we note that this may have some anomalous consequences. For example, if an investment banker were to buy out of the money call options over shares in a company perceived as a potential takeover target and that investment banker were then engaged to advise another company in relation to a bid for the target, it would seem strange that the banker could exercise the call options (which may still be out of the money but below the proposed bid price) on the basis of information gained as an adviser to the bidder.

**Issue 17: What, if any, amendments are necessary to enable uninformed counterparties to informed persons (that is, persons who only receive inside information in the period between entry into and exercise of any option contract) to exercise their physical delivery options?**

See Issue 16

**Issue 18: Should any amendments be made to the current awareness test?**

No.

**Issue 19: Should any amendments be made to the current knowledge test?**

No.

**Issue 20: Should the Australian legislation deal more specifically with the use requirement issue and, if so, in what manner?**

The law should permit people to enter into securities trading plans along the lines permitted by the SEC. Otherwise, no change is necessary.

**Issue 21: Should the legislation permit an informed person to trade contrary to inside information?**

No.

**Issue 22: Should the underwriting exemptions be reformulated and, if so, in what manner?**

See the Committee's comments in relation to Issue 14.

**Issue 23: Should the rules regulating transactions by external administrators be amended and, if so, in what manner?**

The Committee agrees that the rationale for the current exemption is not clear. However, to the extent an external administrator has an obligation to deal in securities in order to perform their duties, it may be appropriate for this duty to prevail over the insider trading prohibition. Otherwise, the people who have the underlying economic interest in the relevant securities may be prejudiced by the accident that the person who happens to have been appointed as external administrator possesses price sensitive information.

**Issue 24: Should persons with confidential price-sensitive information be liable when they instruct a broker to trade, when that broker places the offer on the market, when that offer is accepted by a counterparty broker or at some other time?**

The Committee believes that the relevant time is when the trade is executed. However, consistently with our comments in relation to Issues 16 and 17, the Committee believes that a person should not breach the prohibition if they become aware of relevant information after they have given binding instructions to their broker.

**Issue 25: Should the legal position of intermediaries acting for clients who they know have inside information be clarified and if so, in what manner?**

The Committee supports the views expressed in the Issues Paper.

**Issue 26: Should intermediaries who have been informed by clients that they have inside information be restricted in acting for other clients?**

See Issue 25.

**Issue 27: Should the Chinese Walls defence be amended and, if so, in what manner?**

The Chinese Walls defence should be amended to apply to both the trading offence and the procuring offence.

The Chinese Walls defence should not be removed. It is available in all other jurisdictions and, if it were removed in Australia, all (or almost all) major market participants would effectively be excluded from Australian financial markets.

**Issue 28: Should a derivative civil liability provision be included in the Australian legislation?**

No.

The Committee notes that Part 2.5 of the Criminal Code has deliberately not been extended to the insider trading regime.

**Issue 29: How should the Australian legislation deal with consortium bidders?**

The Committee believes that individual consortium members should be free to trade with the consent of all other members of the consortium.

The law currently permits a bidder to trade ahead of their bid. Members of a possible bidding consortium are in no different position from a single bidder and should not be treated differently even if not all members of the consortium wish to buy a pre-bid stake.

**Issue 30: Do the Australian provisions need any modification for target company directors in the context of takeover bids?**

Target company directors should be permitted to disclose price sensitive information to a bidder or potential bidder if they make disclosure on terms which prohibit dealings until the relevant information has been made generally available (or ceased to be price sensitive). The market is not adversely affected by the disclosure of the information if it is adequately informed prior to the dealing.

**Issue 31: Should white knights be permitted to purchase issued shares when aware of a pending price-sensitive hostile bid not known to the market?**

No.



**Issue 32: Should white knights be permitted to purchase issued shares when aware of any other inside information affecting those shares?**

No.

**Issue 33: Should the regulator be given any additional powers to deal with insider trading?**

The Committee believes that any change should await the Australian Law Reform Commission's review of civil and administrative penalties.

**Issue 34: In what circumstances, if any, should uninformed procured persons not be civilly liable for the profit made or loss avoided by an insider trading transaction?**

Uninformed procured persons should not be civilly or criminally liable.

**Issue 35: Is any amendment to the equal information defence necessary?**

The equal information defence should be retained but should apply to both civil and criminal proceedings. It should also be made clear that the communication of information to a person in order to allow a dealing with that person under the equivalent information defence does not violate the "tipping" provisions.

The Committee also believes that it may be useful to clarify that shares, options and securities may be granted to, and exercised by, employees under employee share and option plans (or individual employment arrangements) even though the employees may be in possession of price sensitive information.

**Issue 36: Should there be a right of compensation for insider trading? If so, who should be eligible claimants and how should compensation be assessed?**

The Committee regards insider trading as an offence as against the market rather than a violation of the rights of individual participants in the market. An insider does not normally induce other people to trade – the counterparties to an insider's trades are usually people who have voluntarily decided to enter the market and who would most likely have transacted with other uninformed market participants if the insider had abstained from dealing.

In these circumstances, any civil remedy for insider trading should be viewed primarily as a further deterrent to the offence rather than a compensation regime. Of course any remedies arising as a result of an

officer's breach of duty or as a result of any misrepresentation or other misleading or deceptive conduct should remain available in accordance with their terms.

Against this background, the Committee opposes the extension of civil claims to all people who deal contemporously.

The Committee also questions whether direct counterparties suffer any loss as a consequence of their orders being matched with those of an insider.

While the Committee does not have a concluded view, it believes it may be more appropriate for either the company or the regulator to have a right to recover a multiple of the insider's profit and to give the Court a discretion over the distribution of the funds recovered along the lines of the New Zealand legislation.

**Issue 37: In what circumstances, if any, should companies whose securities are affected by insider trading be entitled to compensation?**

See Issue 36.

**Issue 38: In what manner should the director notification requirements be amended?**

The Committee questions whether a statutory regime is required in light of the recently revised ASX Listing Rules

**Issue 39: Should the Australian legislation introduce controls over speculative trading by corporate decision makers in the securities of their companies?**

The Committee does not have a view on this. The Committee does, however, believe that it would be desirable to encourage listed entities to adopt policies on trading by executives and officers. That might be done by requiring listed entities to disclose their policies on this subject.

**Issue 40: Should the Australian legislation include a "short swing profit" prohibition? If so, who should be subject to the prohibition?**

The Committee does not have a view on this, but opposes any suggestion that substantial shareholders should be subject to such a regime simply by virtue of their shareholding. The Committee notes that a person may become a substantial shareholder as a result of making a takeover bid and may then sell their stake if they are over-bid by a counterbidder. The

Committee does not believe this should attract any short-swing profits regime.