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INSIDER TRADING
REGULATORY PERSPECTIVES

EDITED BY
C VIDYA

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The Future of Insider Trading in Australia: What did Rene Rivkin Teach Us?

*Juliette Overland**

The case of R v. Rivkin[1] *is one of the very few Australian cases resulting in a conviction for insider trading, making it a landmark case in this area of the law. This article examines developments in Australian law relating to insider trading in light of this decision of the New South Wales Court of Criminal Appeal. Aspects of the insider trading offence which have been clarified by Rivkin's case are examined and discussed, as are those which remain contentious or unclear despite the judgment. The essential elements of the insider trading offence are reviewed in this context, particularly in light of recent legislative reform and relevant academic commentary. This article also considers the role of the courts in interpreting difficult legislative provisions such as the laws regulating insider trading, as well as providing an international perspective by analysing the potential application of key provisions of the legislative regimes of other jurisdictions. Clarification of contentious aspects of insider trading has been much needed, so despite the*

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continuing absence of clarity in relation to some elements of the offence, judicial pronouncement by a higher court on these issues should be viewed as a welcome development to the laws on insider trading.

I. Introduction

Insider trading regulation has long been viewed as an extremely difficult and complicated area of corporate law. Australian insider trading laws have been considered by judges and academics alike to be overly complex, legalistic and unclear,[2] as well as being "couched in language which is difficult of understanding and application."[3] Whilst the analysis of insider trading laws has been a popular topic amongst academic writers in recent times – in particular, on issues such as whether insider trading should be decriminalized, and how to address the perceived difficulties in successfully prosecuting and convicting insider traders[4] – there have been very few prosecutions of insider trading in Australia and, as a result, there are very few decided cases on this area of the law. Indeed, the comment has been made that "there are many more journal articles discussing what [insider trading] should be than reported cases of what it is."[5]

In this context, the prosecution and conviction of Mr. Rene Rivkin for insider trading should be viewed as a landmark case in Australia for several reasons: it is one of the extremely few successful prosecutions of insider trading in Australia, especially one following a plea of "not guilty"; the appeal against the conviction at trial provided a rare opportunity for a higher court to analyse the various elements of the insider trading offence; and several of the legal arguments raised at trial and on appeal were novel and a consideration of those issues affords a greater understanding of the insider trading offence itself.

As there are so few judicial pronouncements on this important but complex area of corporate law, the judgment in *R v. Rivkin*[6] ('*Rivkin's case*') is therefore invaluable to scholars of company and securities law. The judgment of the New South Wales Court of Criminal Appeal examines several aspects of the insider trading offence, the most important and consequential of which are:

a. whether the source of information can form part of the information itself;

b. whether information must be received under an obligation of confidence;

c. whether the tests to determine what an alleged insider trader knew or ought to have known are subjective or objective in nature; and

d. whether the source of information is relevant to its level of materiality.

Each of these issues will be examined in this article and analysed in the context of a review of the essential elements of the insider trading offence, pronouncements from previous cases on insider trading, recent developments and proposals relating to the elements of the insider trading offence and opinions proffered by various academic commentators. The extent to which *Rivkin's case* has clarified certain elements of the law of insider trading, and its likely effect on the future prosecution of insider trading offences, will also be discussed. Aspects of the insider trading offence which remain unclear and have not been resolved by the judgment in *Rivkin's case* will also be highlighted in this article. A brief analysis from an international perspective will follow, as well as a discussion of the role of the courts in resolving uncertainties in the elements of the insider trading offence. Although *Rivkin's case* also addresses other legal issues – such as periodic detention, fitness to stand trial and sentencing – consideration of those issues is beyond the scope of this article, which will focus solely on insider trading law.

II. Background to Rivkin's Case

Rivkin's case received much media attention and publicity at the time of the trial and subsequent appeal, and the general nature of the facts of this case are widely known. Mr. Rivkin wished to sell a house in the eastern suburbs of Sydney and instructed a real estate agent, Mr. Doff, to act on his behalf. Mr Gerard McGowan, the executive chairperson of Impulse Airlines, was interested in purchasing the house and approached Mr. Doff and the group operations manager of the Rivkin group of companies, Mr. Dassakis.

On 24 April 2001, Mr. Doff and Mr. Dassakis arranged a telephone call with Mr Rivkin. Mr. McGowan informed Mr. Rivkin by telephone that he was interested in buying the house, but that he wished to make a conditional offer because he was currently trying to sell his business. When pressed for further details, he informed Mr. Rivkin (as well as Mr. Doff and Mr. Dassakis) that he was trying to "merge" Impulse Airlines with Qantas and was awaiting approval from the Australian Competition and Consumer Commission ('ACCC.) for that deal. Mr. Rivkin told Mr. McGowan that he did not believe that the ACCC would approve such a transaction, but Mr. McGowan informed Mr. Rivkin that he believed ACCC approval would be forthcoming. Mr. McGowan told Mr. Rivkin that he could not now trade in Qantas shares, because of the knowledge Mr. Rivkin now possessed about the proposed deal between Impulse Airlines and Qantas. Mr. Rivkin agreed to give Mr. McGowan a seven-day conditional contract to buy the property, which ultimately did not proceed.[7]

Within a matter of hours of the telephone conversation, Mr. Rivkin gave instructions to a SEATS operator with Rivkin Discount Stockbroking to purchase 50,000 Qantas shares in the name of Rivkin Investments. Mr. Rivkin was the sole director of Rivkin Investments and had a shareholding interest of 11%. On 1 May 2001, on Mr. Rivkin's instructions, the Qantas shares were sold for a profit of $2,664.94. Later that same day, Qantas shares were subject to a temporary trading halt, and Impulse Airlines and Qantas then made a joint announcement that they had entered into a "virtual or contractual merger" (although the actual transaction entered into was not a true merger of the two companies). Following the joint announcement there was a significant rise in the Qantas share price. As Rivkin Investments had already sold its Qantas shares prior to the joint announcement, it did not receive the benefit of that rise in the Qantas share price, although there had been a price rise during the period in which Rivkin Investments had bought and sold Qantas shares.

Mr. Rivkin was charged and prosecuted for insider trading in relation to the purchase and sale of the Qantas shares by Rivkin Investments.[8] Following a jury trial and conviction for insider trading in the New South Wales Supreme Court on 30 April 2003, Mr. Rivkin was fined $30,000 and sentenced to 9 months' periodic detention by Whealy J, on 29 May 2003.[9] The maximum penalty which could have been imposed was a fine of $200,000 or imprisonment for up to 5 years or both.[10] Mr. Rivkin appealed against the conviction and sentence to the New South Wales Court of Criminal Appeal, which delivered its judgment on 5 February 2004. The conviction and sentence were both upheld.

Mr. Rivkin was tried under s1002G(2) of the Corporations Act, 2001 (Cth) ('*Corporations Act*') which has now been replaced by the various provisions of Division 3 of Part 7.10." The amendments contained in these new provisions resulted from the reforms instituted by the Financial Services Reform Act, 2001 (Cth).

III. Relevant Legal Issues

The primary legal issues concerning insider trading which arose for consideration in *Rivkin's case* were:

a. Information: Did Mr. Rivkin actually possess "information"? What is the nature and scope of the information which must be possessed? Can it include the source of the information itself? Must the information be received under an obligation of confidence?

b. General Availability: Was the information possessed by Mr. Rivkin "generally available"?

c. Material Effect on the Value of Securities: Would a reasonable person have expected the information possessed by Mr. Rivkin to have a material effect on the value of Qantas shares (the relevant securities)? Is the source of information relevant when considering its materiality?

d. Knowledge: Should Mr. Rivkin have known that the information was not generally available and that a reasonable person would have expected it to have a material effect on the value of Qantas shares? How subjective are the tests for determining what an alleged insider trader knew or ought to have known?

These issues will be considered in some detail in conjunction with a review of the essential elements of the insider trading offence.

IV. Elements of the Insider Trading Offence

Briefly, insider trading occurs when a person trades in shares or other financial products[12] whilst in possession of price-sensitive information which is not publicly available. The elements of the insider trading offence can be summarised as follows:

1. a person possesses certain information;
2. the information is not generally available;
3. a reasonable person would expect the information to be material (that is, to have a material effect on the price or value of certain securities);

4. the person knows (or should know) that the information is not generally available;
5. the person knows (or should know) that a reasonable person would expect the information to be material; and
6. whilst in possession of the information, the person trades in those securities (that is, buys or sells those securities) or procures another person to trade in those securities.

A brief overview and analysis of the law relating to each of these elements of the insider trading offence will follow. The impact of the decision in *Rivkin 's case* on issues relating to each of these elements will also be examined.

A Person Possesses Certain Information

The first element of the insider trading offence requires that a person possess certain information.[13]

"Information" is defined to include:

a. matters of supposition and other matters that are insufficiently definite to warrant being made known to the public; and

b. matters relating to the intentions or likely intentions of a person.[14]

This broad, inclusive definition in the *Corporations Act* differs significantly from that contained in the legislation preceding both the *Corporations Act* and the Corporations Law, which required the alleged insider trader to possess "specific inform-ation".[15] In recent times, Australian cases have confirmed that the current definition of "information" does not import any requirement of specificity.[16]

Additionally, unlike some overseas jurisdictions,[17] Australian law does not contain any requirement that the alleged insider trader "use" the relevant information. It is enough that the alleged insider trader merely "possessed" the information when they traded (or procured another to trade) in the relevant securities. It is no defence to a charge of insider trading that the alleged insider trader did not rely on the inside information because, for example, they had already planned to trade prior to coming into possession of that information, or that they based their decision to trade on alternative information which was not inside information. Although the

"non-use" argument was not advanced directly by counsel for Mr. Rivkin in *Rivkin 's case*, evidence was led during the trial and on appeal which presumably could be used to support a defence of non-use, if it were available – evidence was led that Mr. Rivkin did not believe the information he received from Mr. McGowan, and that Mr. Rivkin formed his intention to purchase Qantas shares based on discussions with the SEATS operator, and not on the basis on the information he received from Mr. McGowan.[18]

1. Can the Source of Information Form Part of the Information Itself?

In *Rivkin's case,* counsel for Mr. Rivkin argued unsuccessfully that there had been an error of law at trial because the information the Crown alleged that Mr. Rivkin possessed was not "information" for the purposes of the *Corporations Act.* Primarily, this argument was made on the basis that the relevant information possessed by Mr. Rivkin was *not* the actual state of affairs communicated by Mr. McGowan to Mr. Rivkin, but instead the fact that Mr. McGowan had stated that such a state of affairs existed.[19] That is, Mr. Rivkin knew only that *Mr. McGowan had stated* that there was a proposed "merger" deal between Impulse Airlines and Qantas, rather than that such a proposal actually existed. It was argued that Mr. Rivkin could only have been in possession of "information" if he had actually known for certain that a proposal for a "merger" deal definitely existed, which he did not.[20]

The Court rejected this argument easily. Whilst the source of information may obviously impact on its perceived reliability, and this will be discussed further below,[21] it is clear that the source or origin of information can also be considered to form part of that information as well. This was clearly recognized by the Court in *Rivkin's case,* as it concluded that "information included the source *and* state of affairs communicated" (emphasis added).[22]

It is not surprising that the Court reached this conclusion and rejected the proposition that an alleged insider trader would possess "information" only if they had knowledge that a certain state of affairs existed, rather than mere knowledge that someone had said that a certain state of affairs existed. A person should not need to have knowledge or a belief in the truth of information they possess before they are caught by the prohibition on insider trading. It should be enough that the person merely possesses the information. If knowledge as to the truth of information was required, rumours and gossip would almost never amount to "information".

Insiders trading on the basis of a rumour would merely need to argue that they did not necessarily know whether or not the rumour was true, only that they had heard and acted upon it, in order to escape liability. Share trading based upon rumour and speculation could therefore occur almost with impunity, as it would be almost impossible to prove that a person knew information they possessed to be true. This would then add yet another layer of complexity to the already convoluted questions about what an alleged insider trader knew or ought to have know, which will be discussed below.[23] Elaborate tests would need to be developed for the purpose of trying to determine whether or not a defendant had any knowledge as to the truth of information they had received. The imposition of such further tests would not assist in simplifying this already complex area of corporate law.

Clearly, as the definition of "information" includes matters of supposition, and there is no requirement that "information" be specific or precise,[24] a defendant should not be required to have actual knowledge as to the truth of a rumour or any other form of information in order to be caught by the insider trading prohibition.

Additionally, there has been judicial recognition that "information" could include "a rumour that something has happened . . . which a person neither believes nor disbelieves."[25] Presumably therefore, "information" could also include a rumour that *something may be about to happen*, which a person neither believes nor disbelieves.

Issues of reliability and materiality aside, when one considers the types of information which circulate in the financial marketplace, there is obviously a distinction to be made between the following examples of information:

i. A press release addressed to the ASX and signed by the company secretary of ABC Ltd., which states that ABC Ltd., is about to launch a takeover bid for XYZ Ltd.

ii. A statement from a trusted stockbroker that he has heard that ABC Ltd., is about to launch a take-over bid for XYZ Ltd.

iii. A statement overheard whilst walking in the street that a passer-by's brother has heard that ABC Ltd., is about to launch a take-over bid for XYZ Ltd.

If one imagines hearing about each of these pieces of information from a third party, it becomes clear that the source of each piece of information forms a vital part of the information itself. If the source were disregarded as a potential element of the information itself, each piece of information above would be identical – that is, that ABC Ltd., is about to launch a take-over bid for XYZ Ltd. Including the source as part of the information itself substantially changes the nature of each of these three pieces of information.

Obviously rumours which circulate in the financial market place can have an impact on the price or value of securities, whether or not those rumours are actually based in fact. The financial services industry clearly operates, at least occasionally, on the basis of speculation and rumour, as well as on more substantiated sources of information. This must be reflected in market trading offences, such as insider trading. The Court is to be commended for clarifying this issue and making it clear that the source of inside information can form part of the information itself.

2. Is there a Requirement that Information be Received under an Obligation of Confidence?

In *Rivkin 's case*, counsel for Mr. Rivkin contended that, in order to fall within the prohibition on insider trading, any information possessed by an alleged insider trader must have been received under an obligation of confidence. This argument was rejected by the Court, on the basis that there is no reason to suggest that the legislation requires such a condition to be imposed.[26]

It would actually have led to a curious result if the Court had accepted an argument that no offence of insider trading is committed unless the relevant "information" was received under an obligation of confidence. It would generally be assumed that this would only occur in limited circumstances, such as where the source of the information is a person connected with the relevant company who does not wish the information to become widely known.

The imposition of a requirement that information be received under an obligation of confidence would have a similar effect to the imposition of a requirement that a person must have knowledge as to the truth of information received – it would virtually exempt persons trading on the basis of rumour and gossip from the prohibition on insider trading. Whilst adding an additional factual analysis to the question of whether insider trading has occurred – by requiring the tribunal of fact to be satisfied that information was received confidentially - the imposition of such a requirement would not reduce any of the complexity or difficulty associated with the insider trading offence. It would merely permit those who can demonstrate that they did not receive information confidentially or, perhaps more importantly, those against whom it cannot be proved that such confidentially existed, to trade freely on the basis of such information. The most likely beneficiaries of such an additional requirement would be those who trade on rumour and gossip. Once again, the imposition of any further tests would not assist in simplifying this already complex area of corporate law.

The Information is not Generally Available

The second element of the insider trading offence requires that the information possessed by the alleged insider trader is not generally available.[27]

Information is considered to be "generally available" if:

a. it consists of readily observable matter; or

b. ... (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 might be affected by the information; and

(ii) since it was made known, a reasonable period for it to be disseminated among such persons has elapsed; or

c. it consists of deductions, conclusions or inferences made or drawn from either or both of the following:

(i) information referred to in paragraph (a);

(ii) information made known as mentioned in subparagraph(b)(i).[28]

"Readily observable matter" is considered to mean "facts directly observable in the public arena."[29] It does not matter how many people actually observe the information (or, indeed, if any do) so long as it would be possible for them to observe it.[30] Observation can occur by various means – for example, with the use of the "unaided human senses" and with the assistance of devices such as the "telephone, telex, facsimile, television and the internet."[31] Over recent years, there has been considerable confusion as to whether or not information needs to be

readily observable *in Australia* or if it is sufficient if it is readily observable in an overseas jurisdiction. In *R v. Firns*[32] (*'Firns' case'*) the trial judge found that information which was readily observable overseas but not in Australia was not "generally available", and the defendant was convicted of insider trading.[33] However, in *R v. Kruse*[34](*'Kruse's case'*), a case based on an almost identical situation, the trial judge found that, in order to be considered to be "generally available", it is sufficient if information is readily observable overseas, and the defendant was not convicted of insider trading. These two decisions appear irreconcilable,[35] but the conviction in *Firns' case* was overturned on appeal by the New South Wales Court of Appeal anc the majority of the Court found that information need only be readily observable ir an overseas jurisdiction for it to be "generally available", although Carruthers A. delivered a strong dissenting judgment. The majority judgment in the appeal in *Firns* *case* now appears to represent the current state of the law, but the question as tc who must be able to observe the relevant information, and where they must be abl to observe it, has remained a contentious issue.[36]

1. Determining when Information is Generally Available

At trial, counsel for Mr. Rivkin unsuccessfully tried to argue that the informatio which Mr. Rivkin possessed was generally available, due to the existence c rumours in the press about the possibility of deals being done between two of tl then four airlines operating domestically, as well as rumours about the possib collapse of Impulse Airlines. Whilst such rumours existed, the Crown was able demonstrate an absence of information in the media about the propos "merger" as described by Mr. McGowan to Mr. Rivkin. The Crown called exp evidence from several witnesses in the stockbroking industry, who testified tl they were unaware of any rumours of such a proposal prior to the jo announcement by Impulse Airlines and Qantas on 1 May 2001.

As the Crown's evidence on this point was accepted, it was unnecessary for trial judge or the New South Wales Court of Criminal Appeal to consider whetl the existence of rumours about the proposed "merger" would have meant that information was "generally available". This is an interesting issue because status of rumours as a source of information has not previously been the sub of judicial pronouncement in Australia and guidance from the Court on this tc would have been of great assistance.