Submission to Corporations and Markets Advisory Committee
Aspects of Market Integrity

Spreading False or Misleading Information

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1. Introduction

The modern share market operates based on the efficient market hypothesis that share prices fully reflect all available information and that requiring mandatory disclosure of price-sensitive information, that may otherwise remain private, promotes the accuracy of share prices.[1] Equally, false or misleading information may be used to artificially effect share prices and as a result market confidence. Despite reliance on the efficient market hypothesis, irrational behaviour by investors has been found to occur, particularly in times of uncertainty, providing a strong justification for regulatory intervention.[2]

An efficient market is supported by disclosure requirements and prohibitions on misleading information. The main aim of continuous disclosure is to enhance confident and informed participation by investors in secondary securities markets.[3] Continuous disclosure is also fundamental to corporate governance and investor protection through preventing insider trading and market manipulation.[4]

International Organization of Securities Commissions (IOSCO) in its Objectives and Principles of Securities Regulation states:

> The regulation of trading in the secondary market should prohibit market manipulation, misleading conduct, insider trading and other fraudulent or deceptive conduct which may distort the price discovery system, distort prices and unfairly disadvantage investors. Such conduct may be addressed by direct surveillance, inspection, reporting, product design

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1 See Entcho Raykovski, Continuous Disclosure: Has Regulation Enhanced the Australian Securities Market? (2004) 30 (2) *Monash University Law Review* 268 at 270 and Angie Zandstra, Jason Harris and Anil Hargovan, Widening the net: Accessorial liability for continuous disclosure contraventions (2008) 22 *Australian Journal of Corporate Law* 51 at 54-55 explaining the theoretical basis of continuous disclosure.

2 Entcho Raykovski, Continuous Disclosure: Has Regulation Enhanced the Australian Securities Market? (2004) 30 (2) *Monash University Law Review* 268 at 272.

3 Companies and Securities Advisory Committee, *Report on an Enhanced Statutory Disclosure System*, September 1991 p 6-7 and Corporate Law Economic Reform Program, *Corporate Disclosure: Strengthening the Financial Reporting Framework*, Paper No 9 (2002) p 129.

4 Corporate Law Economic Reform Program, *Corporate Disclosure: Strengthening the Financial Reporting Framework*, Paper No 9 (2002) p 129 and Belinda Gibson, Commissioner, ASIC, 'Improving confidence and integrity in Australia's capital markets', Presentation to the Committee for Economic Development of Australia (CEDA), Sydney, 8 July 2008 at 2. Available at: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Integrity_capital_markets_Gibson_July_2008.pdf/$file/Integrity_capital_markets_Gibson_July_2008.pdf

requirements, position limits, settlement price rules or market halts complemented by vigorous enforcement of the law and trading rules.[5]

The IOSCO Public Document No. 103, Investigating and Prosecuting Market Manipulation, IOSCO Technical Committee, May 2000 goes into further detail including:

> Public confidence in the fairness of markets enhances their liquidity and efficiency. Market manipulation harms the integrity of, and thereby undermines public confidence in, securities and derivatives markets by distorting prices, harming the hedging functions of these markets, and creating an artificial appearance of market activity.[6]
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> …
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> A number of [market manipulation] methods used include:
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> Dissemination of false or misleading market information through media, including the Internet, or by any other means. The dissemination is done in order to move the price of a security, a derivative contract or the underlying asset in a direction that is favorable to the position held or a transaction planned by the person disseminating the information.[7]

The activity of rumour-mongering has an adverse effect on market integrity.

2. Possible amendment of sections 1041E, 1041F and 1041G

The CAMAC discussion paper observed that "this is an area where there are practical problems in uncovering evidence and in proving each of the elements of an offence beyond reasonable doubt".[8] There is some suggestion that the existing provisions may be rendered easier to prove through making the sections civil penalty provisions or by making the elements of the section easier to prove regardless of whether the criminal or civil standard of proof applies.

It is important in regulation, as in law generally, to send clear messages about acceptable and unacceptable conduct. One important distinction the law draws is between behaviour that exposes one to liability to compensate victims and behaviour that is morally condemned by society generally: that is between civil and criminal liability. A fundamental principle of criminal liability is that the wrongness of criminal behaviour lies in the mental state with which a person does the act. Justice Brennan in *He Kaw Teh v R* observed that "The requirement of mens rea avoids 'the public scandal of convicting on a serious charge persons who are in no way blameworthy'."[9]

Degrees of wrongness are seen to often lie in the different forms of intention or knowledge offenders have at the time the act is committed. The degree of criminality can at times also lie in the acknowledged harm that the activity can cause.[10] In instances where the harm is severe and there is

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5 International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation* (May 2003) p 43.

6 IOSCO Public Document No. 103, Investigating and Prosecuting Market Manipulation, IOSCO Technical Committee, May 2000 ("IOSCO No. 103") at 1 Available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD103.pdf

7 IOSCO No. 103 at 6

8 Corporations and Markets Advisory Committee, Aspects of market integrity (2009) p 25.

9 *He Kaw Teh v R* (1985) 157 CLR 523, 565 citing *Sweet v. Parsley* [1970] A.C. 132. 150.

10 For nuanced discussion of these issues see Stuart Green, Lying, Cheating and Stealing: A Moral Theory Of White-Collar Crime (2006) and Caron Beaton-Wells, "Capturing the Criminality of Hard Core Cartels: The Australian Proposal"(2007) 31 MULR 675.

no social utility in the doing of the act, less emphasis may be placed on the mental state and the act still be seen as criminal. For example, homicide is considered in most instances to be an abhorrent act with no social utility. If the offender causes a death intentionally or with recklessness as to death or serious injury the crime of murder is committed.[11] However, given the severe harm represented by death liability can also exist if the offender acts without any mental awareness that they may cause death, provided the act is sufficiently negligent.[12]

On the other hand, if the act that constitutes the crime is one that is socially beneficial in some circumstances,[13] or the act is one that is regularly committed with no real harm caused,[14] the emphasis in determining criminal liability rests strongly on the mental intentions and knowledge of the accused. This is particularly important in a business setting.

The nature of the conduct that is under consideration, the spreading of false rumours, is a form of behaviour that is in general terms central to financial markets. That is, the communication of information about businesses, shares, and financial products is at the very core of a market. In modern electronically mediated markets, information and share trading occur at extremely fast rates, and often information is passed that is less than perfect or fully researched. It would be highly stifling if participants in a market felt that they were prohibited from passing on information that was not extensively checked for veracity.

In these circumstances, there is not a clear dichotomy between truth and rumour. Instead there is a sliding scale of reliability of information. At one end the reliability becomes so thin that is can be characterised as a rumour, but that point is liable to be not easily demarcated, other than when the information is clearly not verifiable.

Similarly, the falsity of information operates on a sliding scale from information that is totally false to information that contains elements of a misleading nature. In order to deal with this the criminal law requires that communication that is sufficiently false to raise the possibility of criminal liability must be false in a "material particular", as do sections 1041E and 1041F. This materiality is determined objectively, but importantly from the perspective of the recipients not the communicator.[15] Thus information can be found to be false even though the communicator strongly believes it to be true.

Because of these considerations it is important to strike an appropriate balance between protecting the integrity of market information and also acknowledging that market participants regularly pass on information that may be speculative or that they wrongly believe to be accurate.

The current regulation of information sharing in the Corporations Act seeks to strike that balance. It recognises that individual fault aside, participants in a market should be able to expect that information is accurate. As such, the Act provides for a broad basis for civil compensation for loss in s1041H. Liability under section 1041H is relatively easy to establish because:

- The conduct may be directed to an unidentified group of people so that a representative member of that group must be determined by the court to ascertain if the conduct is misleading or

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11 See eg *Crabbe v R* (1985) 156 CLR 464

12 See eg *R v Lavender* (2005) 222 CLR 67

13 Such as sexual intercourse.

14 Lying through exaggeration in social interaction could be an example.

15 Cf *ASC v Macleod* (2000) 18 ACLC 424

deceptive.[16] The ordinary or reasonable representative of that group may be an unsophisticated retail level investor or a person without experience in dealing with shares, which increases the likelihood that they may be misled.[17]

- The connection between a misleading statement and a share so as to attract the operation of section 1041H of the Corporations Act can be indirect or less than substantial.[18]
- Intention is irrelevant. The provisions are drafted so as to be concerned with consequences and not the contravener's state of mind.[19]

However, section 1041H is not a civil penalty provision. It grounds civil liability only. ASIC is able to seek an injunction to prevent or stop a person from contravening section 1041H and in addition or in substitution seek damages.[20] ASIC may also pursue compensation orders on behalf of persons who suffered or are likely to suffer loss or damage because of the contravention of section 1041H.[21] ASIC cannot seek a pecuniary penalty order pursuant to section 1317G.

The existence of such a civil basis for compensation means that any justification for criminal liability is not based on a need to provide any indirect avenue for compensation of victims. Instead, criminal liability is only required to express social denunciation of behaviour that is seen to be so far from acceptable that it deserves criminal sanction.

As will be seen, the authors do not consider that there are forms of behaviour that fall outside of the current offences that would justify an action by ASIC via civil penalty provisions.

(a) Section 1041E

As a default, criminal liability for the spreading of false rumours should only arise if the offender deliberately passes on false information with an intention to induce a person rely on that information to their detriment, or to the offender's benefit. This is the form of behaviour that the Minister's letter is concerned about and is at the crux of the Committee's enquiry. Such behaviour clearly falls within the current ss1041E, 1041F and 1041G.

It is also generally accepted that because of the known harms that can be caused by the spreading of information that criminal sanction should extend to any person who spreads the information with a knowledge that there is a substantial risk that it might be false and that it is unjustifiable to take that risk (that is, recklessly, as defined under the Criminal Code s5.4). Currently such an awareness can form

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16 *Campomar Sociedad, Limitada v Nike International Ltd* (2000) 202 CLR 45, 85: followed in *National Exchange Pty Ltd v Australian Securities and Investments Commission* (2004) 49 ACSR 369, [18]–[19] in relation to s 1041H(1).

17 *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452, 467; *Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199 (Unreported, Queensland Court of Appeal, Williams and Keane JJA, Atkinson J, 10 June 2005) [65].

18 *Australian Securities and Investments Commission v Narain* (2008) 66 ACSR 688, [9], [76].

19 *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216, 228, (Stephen J): 'As I read s 52(1) ... it is concerned with consequences as giving to particular conduct a particular colour. If the consequence is deception, that suffices to make the conduct deceptive'; *Brown v Jam Factory Pty Ltd* (1981) 53 FLR 340, 348; *Australian Securities and Investments Commission v Online Investors Advantage Inc* [2005] QSC 324 (Unreported, Supreme Court of Queensland, Moynihan J, 26 October 2005) [138] dealing with section 1041H(1) of the *Corporations Act* and section 12DA(1) of the *ASIC Act*.

20 Section 1324 (1) and (10).

21 Section 1325.

the basis of liability under s1041E. However recklessness is expressed in the terms "does not care." **Consideration should be given to re-wording the recklessness element of s1041E to be in conformity with recklessness under the Criminal Code to ensure a consistent approach to the mental state throughout Commonwealth law. This is particularly the case in light of the use of "reckless" in s 1041F**.

However, the section also extends liability in some circumstances to a person who unwittingly passes on false information. Those circumstances are when the communicator "ought reasonably to have known" This form of liability is unusual in criminal law, but can be justified if the harm caused by the activity is so great that any person engaging in it has a responsibility to take care.[22] The minimum standard for liability under s 1041E is thus one of negligence. It is based on the fact that the offender does in fact not know the information is false, but should have realised this. This can be justified in this instance because of the levels of responsibility borne by, and trust placed in, those who deal in financial products both to the market and its regulators but also to the public and others involved in the market.

Below this minimum level of criminal liability are only situations where a person passes on false information in circumstances where no reasonable person could have been expected to know that the information was false. Such instances do not form a principled or necessary basis for criminal liability. If liability were extended to these instances, any penalty that would be applicable would be minimal as a court would be required to sentence on the basis that no other reasonable person in that situation would have done otherwise. Unless knowledge was contested, it would be unlikely that ASIC would pursue prosecution.

Similarly there is no need for any civil penalty provision to be coupled to this offence. Given that the minimum fault requirement for breach of s1041E is an objective test of reasonableness, a civil penalty would not act to make proof easier except in two instances. The first would be where the falsity was not to be reasonably known, and the second would be whether there was doubt as to whether the defendant was the person who had disseminated the information. In both cases, it would be inappropriate to impose penalties.

It is submitted that there is no need or justification for any amendment to s 1041E.

(b) Section 1041F

This section contains a number of fault elements. Making or publishing a statement etc requires recklessness as defined in the Criminal Code s 5.4. Concealment of facts requires dishonesty as defined in the Criminal Code s 130.3. Recording information requires knowledge.

It is submitted that this is unfortunate and a consistent fault element be required for all three forms of behaviour. The Criminal Code uses recklessness as the default fault element for offences where the physical element involves circumstances or results (s 5.6(2)). As this offence requires the result of an inducement, recklessness is the appropriate fault element. Similarly, the falsity of information is a circumstance and consequently recklessness as to the existence of such falsity is appropriate.

It is submitted that the fault elements for s 1041F be recklessness as defined in the Criminal Code.

Given that the appropriate fault element for s1041F is recklessness there may be scope to introduce a civil penalty offence to complement the section. The difficulty with so doing would be the need to consider the extent to which liability would be strict. For example it might be seen to be overly heavy-handed to expose to liability persons who had not intended nor were reckless as to whether their actions would induce dealing in the financial product.

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[22] An example of this is the offence of negligent driving.

Because of the overlap between ss 1041E and s 1041F(1)(a) any civil penalty provision should probably expressed to only cover those forms of dealing outside of the scope of s 1041E(2). Indeed it may be questionable whether those forms of dealing have potential to affect the market in the same way as inducing application and disposal of financial products, and if so, whether civil penalties are necessary.

Given the ability of internet based information to spread rapidly and widely, it might be appropriate to create a civil penalty regime for s 1041F(c). However, it is arguable that electronic storage of information that is accessible via the internet amounts to dissemination of information, and thus would fall within s 1041E, reducing the strength of any case for a civil penalty for this behaviour.

It is submitted that there is not a clear case for amending s 1041F to include civil penalty provisions.

(c) Section 1041G

It is unfortunate that the use of dishonesty in the Corporations Act is not uniform. While dishonesty in sections 1041F and 1041G are defined in terms of the Criminal Code adoption of the test derived from *R v Ghosh*,[23] the use of dishonesty in s184 is not so defined. Indeed s184(1) requires a compound concept of intentional dishonesty. It is submitted that for consistency any use of dishonesty in the Corporations Act should conform to the Criminal Code definition, as s1041G currently does. It is a failure of the current form of the Corporations Act that this is not uniformly the case, and has the potential to create considerable uncertainty of interpretation.

The definition of dishonesty in the Criminal Code was the result of a clear decision by the Federal Parliament to reject the approach to dishonesty favoured by the High Court in *Peters v R*.[24] In so doing, the Parliament made clear that dishonesty is a fault element, not a physical element, though there is some academic debate over whether it is a purely fault element of a compound of physical and fault.[25] Analysis of the decision of the High Court in *Peters v R* may suggest that the High Court considered dishonesty when used as an aspect of "dishonest means" in defrauding applied to a physical element of an offence.[26] If so, it is submitted that the definition of dishonesty in the Criminal Code and in the present s1041G rejects that characterisation of dishonesty.

Instead s1041G represents a general offence that prohibits behaviour that is otherwise not clearly prohibited by Part 10, where the offender knows that such behaviour would not be considered acceptable practice by ordinary people. There may be controversy about the use of such generalised and undefined behavioural standards in business regulation, and this is certainly the case in relation to the proposed Trade Practices Act 1975 cartel offences.[27] Putting that considerable issue to one side, it

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23 [1982] QB 1053

24 (1998) 192 CLR 493. The High Court held that dishonesty was to tested against the standards of ordinary decent people, but that the awareness of this by the accused was irrelevant. In so doing, they rejected the approach in *Ghosh*.

25 See eg Stephen Odgers, Principles of Federal Criminal Law (2007); Ian Leader-Elliott, "Cracking the Criminal Code: Time for Some Changes" U. of Adelaide Law Research Paper No. 2009-003.

26 See eg Alex Steel, "Describing Dishonest Means: The Implications Of Seeing Dishonesty As A Course Of Conduct Or Mental Element" (2009) Adelaide Law Review (forthcoming)

27 See eg the submissions to the Criminal Penalties for Serious Cartel Conduct – Draft Legislation Discussion Paper issued by Treasury in January 2008. The submissions can be found at: http://www.treasury.gov.au/contentitem.asp?ContentID=1350&NavID=006

is clear that the only basis for liability under s1041G is that the conduct is dishonest. Otherwise the conduct, in the terms of the section, is entirely lawful.

It is therefore not logically possible to either create a lower fault threshold or amend it to a civil penalty provision.

It is submitted that no amendment be made to s 1041G

If CAMAC were minded to introduce a civil penalty provision then the *Financial Services and Markets Act 2000* (UK) provides an example of a regulatory framework where market manipulation may attract both civil penalties and criminal prosecution (see annexure A). The civil penalty may be imposed if the person engages in market abuse ie the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question.[28] Liability is strict, but may be avoided by proof of defences of reasonable mistake or due diligence.[29] Importantly, the burden of proving such defences lies on the defendant. Such a burden would act as an incentive for organisations to maintain effective compliance programs, a matter discussed in more detail below. The scope of any such defences would in practice define the offence, and given that the burden of proof would fall on the defendant, more consideration of the nature of those defences would need to be made before it would be appropriate for CAMAC to form a final view on the matter.

3. Obtaining Evidence

A perceived problem with the provision is that it is difficult to obtain the evidence to prove a contravention. A complaint that appears to have existed since at least 2000.[30] However, it should be noted that the section has been successfully used, for example, *R v Adler* (2005) 53 ACSR 471, *ASIC v Elm Financial Services Pty Ltd* [2005] NSWSC 1020, *ASIC v Preston* [2005] FCA 1805 and *ASIC v Macleod* (2000) 22 WAR 255.

The suggestion for improving the ability of ASIC to prosecute cases is to require the recording of electronic communications similar to that recommended by the FSA.[31] The FSA has estimated that the proposal will give rise to a one-off industry costs of £9-14 million and ongoing annual costs of £6-11 million.[32] The utility of the rules has attracted scepticism[33] and there also appears to be gaps in the

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28 *Financial Services and Markets Act 2000* (UK) sections 118 and 123.

29 *Financial Services and Markets Act 2000* (UK) section 123(2).

30 IOSCO No. 103 at 21 ("In many jurisdictions, there is a different standard of proof for civil, administrative, and criminal actions, with the highest standard of proof required for criminal proceedings. In all three types of cases, it will often be difficult for the regulatory authority or prosecutor to obtain direct evidence -- either through documents or testimony -- of manipulation.").

31 FSA Policy Statement 08/01 *Telephone Recording: recording of voice conversations and electronic communications* (March 2008).

32 FSA Policy Statement 08/01 *Telephone Recording: recording of voice conversations and electronic communications* (March 2008) 11.

33 See In Principle - A Newsletter from Bingham McCutchen's Financial Regulatory Practice (Autumn 2008) p16 ("It remains to be seen whether the new rules will deliver tangible results for enforcement for market abuse; the overall view at the moment remains sceptical.") Available at http://www.bingham.com/Media.aspx?MediaId=7677 and The Financial Services newsletter from DLA Piper UK LLP (Summer 2008) p13 ("It is unclear to what extent the FSA is, in reality, being hampered in its investigations by a lack of tape-recorded evidence."). Available at

rules (ie not applicable to mobile telephones or other handheld electronic devices) that make it easy for the dishonest or intentional contravener to avoid being recorded. The FSA's own report only states that recording communications "may" increase the probability of successful enforcement.[34]

The authors are not opposed to the recording of electronic communications but a cost-benefit analysis needs to be undertaken before electronic communications recording rules are mandated. Such a study needs to consider the scope of the proposed rules (which markets and which functions in those markets are to be subject to the recording requirement) and the ease with which the requirements could be circumvented.

Consideration should be given to other alternatives to assist in the gathering of evidence. Three options worthy of consideration are:

1. **Immunity agreements**
2. **Requirement to inform ASIC of receipt of rumour**
3. **Telephone tapping**

The FSA has sought the ability to plea bargain or offer immunity to whistle blowers who come forward and report insider trading.[35] Such an approach could also be used in relation to market manipulation. A useful analogy would be the ACCC immunity policy for cartel conduct.[36] The ACCC's immunity policy interpretation guidelines state:

> International experience has demonstrated that an effective immunity policy encourages businesses and individuals to disclose cartel behaviour and this in turn assists the ACCC to stop the harm of the illegal conduct and prosecute participants.
>
> Just as importantly, an immunity policy that provides incentives to businesses and individuals to disclose illegal behaviour is also a powerful disincentive to the formation of cartels, as potential participants will perceive there then exists a greater risk of ACCC detection and court proceedings.[37]

The same reasoning may apply to market manipulation. An individual that engages in rumourtrage will have an incentive to confess to ASIC to avoid prosecution. Equally the possibility that a co-conspirator may seek immunity from ASIC is a powerful disincentive to engaging in market manipulation in the first place.

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http://www.dlapiper.com/files/Publication/eb6bed4d-b3c2-4d69-a860-1f79bb790d66/Presentation/PublicationAttachment/8ca98508-fa60-4bda-82ac-20a8ac5ae54c/Fit%20and%20Proper%20-%20Summer%2008.pdf

34 FSA Policy Statement 08/01 *Telephone Recording: recording of voice conversations and electronic communications* (March 2008) 5 and 15.

35 See Margaret Cole, Director of Enforcment, FSA, The FSA's Market Abuse Strategy: Prevention & Cure, 29 June 2007. Available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0629_mc.shtml and BBC News, Treasury eyes whistleblower plan, 28 March 2008. Available at http://news.bbc.co.uk/1/hi/business/7317845.stm

36 See ACCC Immunity Policy for Cartel Conduct (26 August 2005) Available at (http://www.accc.gov.au/content/item.phtml?itemId=708758&nodeId=b42265c7fbeee88cf1cd2851c337c446&fn=Immunity%20policy.pdf

37 ACCC Immunity Policy Interpretation Guidelines (26 August 2005) 1, Available at http://www.accc.gov.au/content/item.phtml?itemId=708758&nodeId=41d82c581d6ec27bea392f9c89246db5&fn=ACCC%20immunity%20policy%20interpretation%20guidelines.pdf

Consideration should also be given to adopting a requirement that a person who receives a statement or information that is materially false or is materially misleading, ie a rumour, should be obligated to inform ASIC of its receipt and source. This would be similar to sections 311 and 601HG in relation to auditors who have an obligation to report to ASIC of a suspected contravention of the Corporations Act.[38] Provision would also need to be made for the extension of a qualified privilege to the person informing ASIC. Although the requirement is stated as applying to a person above, it may be more workable to define the persons who have the obligation more strictly, such as by reference to stock brokers or the holders of an Australian Financial Services Licence.

Market manipulation relies in the misleading information being disseminated, so that multiple people must become involved, and secrecy so that those engaging in rumourtrage are not caught. The immunity and reporting requirement suggestions increase the risk that secrecy cannot be maintained.

Telephone tapping is currently not available for a suspected offence under section 1041E. Market manipulation is currently not classified as a "serious offence", under the *Telecommunications (Interception and Access) Act 1979* (Cth). It is neither specifically listed as a serious offence nor does it attract the requisite penalty of at least 7 years imprisonment.[39] ASIC is not an "agency" for the purposes of the Telecommunications (Interception and Access) Act and is unable to apply for or obtain a telecommunications interception warrant.[40] The availability of telephone tapping has been suggested as a way to overcome ASIC's inability to obtain the necessary evidence.[41]

Such a power could be given to either the Australian Federal Police or ASIC. The authors prefer the former as they have a broader responsibility to the public and can weigh the social benefits and costs of such intrusive powers across a broader range of interests. Further, if ASIC were to be granted such powers there would necessarily need to be described limits on the persons and circumstances in which the phone-taps could be granted. No such restrictions need apply if the AFP were able to undertake the interception.

The utility of telephone tapping needs to be considered in greater detail as it will be necessary set out the facts and other grounds on which the application for a warrant is based. The difficulty in obtaining evidence to prosecute the offence may also mean that there will be difficulty in satisfying a judge that a warrant should be issued. Further, it is likely that by the time ASIC (probably through the ASX) becomes aware that rumourtrage may be occurring in relation to a particular security the offending conduct may have occurred before any telephone tapping can take place.

If telephone-tapping were considered necessary, it is submitted that the most appropriate method by which this could be achieved would be to increase the maximum penalty for the offences to 7 years from their current 5. This would then bring the offences within Telecommunications (Interception and Access) Act s5D(2)(a). In order to obtain a warrant the AFP would further be required by s 5D(2)(v) to establish that the activity amounted to serious fraud. This would both maintain the current regime of seriousness in terms of applicable penalty and also require that in each application evidence of potentially serious harm would be required.

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38 See Michael Legg, An Auditor's Obligations to Report to ASIC – Between the Hammer and the Anvil (2005) 23 *Company and Securities Law Journal* 264.

39 *Telecommunications (Interception and Access) Act 1979* (Cth) section 5D.

40 *Telecommunications (Interception and Access) Act 1979* (Cth) section 5.

41 See Andrew Main, ASIC must be given phone tap power, *The Australian*, 3 February 2009, http://www.theaustralian.news.com.au/business/story/0,28124,24999257-36418,00.html

4. Continuous Disclosure

CAMAC's Issue Paper stated that:

> Rumours can be initiated for various purposes. For instance, they may be created to misinform the market about the true financial position of a company, with the intention of artificially deflating or increasing the market price of its shares. Other rumours may be circulated in an attempt to force a company to acknowledge or disclose market-sensitive information otherwise exempt from disclosure requirements. An example would be a rumour concerning an incomplete proposal or negotiation that up to that point had not been publicly disclosed, in reliance on an exception to the continuous disclosure obligation under ASX Listing Rules.[42]

This submission focuses on the second type of rumour referred to by CAMAC.

The more likely that a rumour may have an element of truth to it, the more harmful that rumour is. A half truth is like a half brick, it travels further and does more damage. It may therefore be useful to reduce the opportunity for rumours to emanate from a source that is most likely to have some semblance of truth to it - the corporation about which the rumour is circulating. This requires a strengthening of confidentiality.

The issue of rumourtrage could be combated by amending the listing rules as follows:
1. the exceptions to disclosure set out in Listing Rule 3.1A can only be relied upon if the corporation has in place a compliance system for providing reasonable assurance that confidential information is indeed kept confidential. The directors must certify that such a compliance system exists in the annual and half-yearly accounts. If such a certification is in place then there is a presumption that the corporation may respond to any rumours in the market by citing the existence of its compliance system. The presumption is rebutted by a showing that the compliance system has failed ie the rumour is from the company or an advisor to the company who received confidential information.
2. if a rumour about a corporation is communicated then there will be a presumption that a false market exists and that the corporation must promptly confirm or deny the rumour. The presumption will not apply if a compliance system for providing reasonable assurance that confidential information is indeed kept confidential.

The requirements for a confidentiality compliance system could be usefully mandated or described by the ASX or ASIC. Equally there could be a requirement for a compliance plan to be registered with the ASX.

The aim here is two-fold. The first aim is to provide an incentive for corporations to take a tougher line on enforcing confidentiality. Just as AFSL holders are required to manage conflicts pursuant to section 912(1)(aa), listed corporations must protect confidentiality. In *ASIC v Chemeq*, Justice French (as he then was) opined:

> Compliance policies and procedures will not be effective unless there is, within the corporation, a degree of awareness and sensitivity to the need to consider regulatory obligations as a routine incident of corporate decision-making. This kind of general sensitivity to the issues underpins what is sometimes called a "culture of compliance". It does not require a risk adverse mentality in the conduct of the company's business, but rather a kind of inbuilt mental check list as a background to decision-making.[43]

The above recommendations build on the general sensitivity as to compliance obligations that are currently expected and require systems that promote and protect confidentiality.

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42 Corporations and Markets Advisory Committee, Aspects of market integrity (2009) p 26.

43 *ASIC v Chemeq* [2006] FCA 936 at [86].

Second, remove the incentive for those persons who seek to use a rumour to try and force a corporation to confirm whether a particular transaction is taking place by trying to create a false market or suggest that confidentiality has been lost. If the compliance system works then there should be no 'informed' rumours unless a person deliberately seeks to breach confidentiality. Such a person should be able to be more readily identified if a functioning compliance system is in place as the company should know every person that has had access to the confidential information.

The authors acknowledge that the above approach would require a change to the current ASX approach to confidentiality where once the ASX determines that confidentiality is lost, even when confidentiality arrangements are in place and/or the information has come from a source other than the entity, disclosure must follow.[44]

As for the suggested recording of electronic communications recommendation, there should be a cost-benefit analysis of lifting the bar for non-disclosure.

[44] ASX, *Guidance Note 8 - Continuous Disclosure Listing Rule 3.1* (June 2005) at [34].

Annexure A
Extracts from Financial Services and Markets Act 2000 (UK)

Available at http://www.opsi.gov.uk/ACTS/acts2000/ukpga_20000008_en_1

118 Market abuse
(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert)—
(a) which occurs in relation to qualifying investments traded on a market to which this section applies;
(b) which satisfies any one or more of the conditions set out in subsection (2); and
(c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.
(2) The conditions are that—
(a) the behaviour is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected;
(b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question;
(c) a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.

123 Power to impose penalties in cases of market abuse
(1) If the Authority is satisfied that a person ("A")—
(a) is or has engaged in market abuse, or
(b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse,
it may impose on him a penalty of such amount as it considers appropriate.
(2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that—
(a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or
(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.
(3) If the Authority is entitled to impose a penalty on a person under this section it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse.

397 Misleading statements and practices
(1) This subsection applies to a person who—
(a) makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular;
(b) dishonestly conceals any material facts whether in connection with a statement, promise or forecast made by him or otherwise; or
(c) recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular.
(2) A person to whom subsection (1) applies is guilty of an offence if he makes the statement, promise or forecast or conceals the facts for the purpose of inducing, or is reckless as to whether it may induce, another person (whether or not the person to whom the statement, promise or forecast is made)—
(a) to enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement; or
(b) to exercise, or refrain from exercising, any rights conferred by a relevant investment.

(3) Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so for the purpose of creating that impression and of thereby inducing another person to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments.
(4) In proceedings for an offence under subsection (2) brought against a person to whom subsection (1) applies as a result of paragraph (a) of that subsection, it is a defence for him to show that the statement, promise or forecast was made in conformity with price stabilising rules or control of information rules.
(5) In proceedings brought against any person for an offence under subsection (3) it is a defence for him to show—
(a) that he reasonably believed that his act or conduct would not create an impression that was false or misleading as to the matters mentioned in that subsection;
(b) that he acted or engaged in the conduct—
(i) for the purpose of stabilising the price of investments; and
(ii) in conformity with price stabilising rules; or
(c) that he acted or engaged in the conduct in conformity with control of information rules.
(6) Subsections (1) and (2) do not apply unless—
(a) the statement, promise or forecast is made in or from, or the facts are concealed in or from, the United Kingdom or arrangements are made in or from the United Kingdom for the statement, promise or forecast to be made or the facts to be concealed;
(b) the person on whom the inducement is intended to or may have effect is in the United Kingdom; or
(c) the agreement is or would be entered into or the rights are or would be exercised in the United Kingdom.
(7) Subsection (3) does not apply unless—
(a) the act is done, or the course of conduct is engaged in, in the United Kingdom; or
(b) the false or misleading impression is created there.
(8) A person guilty of an offence under this section is liable—
(a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both;
(b) on conviction on indictment, to imprisonment for a term not exceeding seven years or a fine, or both.
(9) “Relevant agreement” means an agreement—
(a) the entering into or performance of which by either party constitutes an activity of a specified kind or one which falls within a specified class of activity; and
(b) which relates to a relevant investment.
(10) “Relevant investment” means an investment of a specified kind or one which falls within a prescribed class of investment.
(11) Schedule 2 (except paragraphs 25 and 26) applies for the purposes of subsections (9) and (10) with references to section 22 being read as references to each of those subsections.
(12) Nothing in Schedule 2, as applied by subsection (11), limits the power conferred by subsection (9) or (10).
(13) “Investment” includes any asset, right or interest.
(14) “Specified” means specified in an order made by the Treasury.