‘POSSESSION’ OF INFORMATION IN THE INSIDER TRADING OFFENCE

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Insider Trading—Possession of Information—Subjective Awareness Test for Possession—R v Fysh

Insider trading is a serious corporate crime that has the capacity to significantly undermine the integrity of the securities market, as ‘insiders’ are able to unfairly benefit from information that is not publicly available. Unfortunately, the legislative framework prohibiting insider trading in Australia is widely considered complex and unclear. The case of Fysh v R[1] *presented a rare opportunity for judicial clarification of one element of this offence – specifically, the meaning of ‘possession’ of inside information. The case impliedly confirmed that mere physical possession, without awareness, is insufficient to amount to ‘possession’. This appears to impose a higher evidentiary burden on the prosecution, as it requires proof of subjective awareness on the part of the ‘insider’. This article argues that this interpretation of ‘possession’ in this case was correct in light of the limited previous case law on this issue, and the fact that ‘awareness’ better encompasses both tangible and non-tangible forms of inside information. It also includes discussion of possible law reform that could assist the prosecution in future cases in proving this subjective element of the offence.*

I INTRODUCTION

Insider trading is a controversial area of corporate law, and is notoriously under-prosecuted.[2] The insider trading provisions of the

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1 [2013] NSWCCA 284.

2 Juliette Overland, ‘Re-evaluating the Elements of the Insider Trading Offence: Should there be a Requirement for the “Possession” of Inside Information?’ (2016) 44 *Australian Business Law Review* 256, 256; Ann O’Connell, ‘Securities

Corporations Act 2001 (Cth) ('Act') proscribe a person from trading in or procuring securities or other financial products while possessing information which he or she knows, or ought to know, is not generally available and is price-sensitive.[3] The rationale for prohibiting insider trading is the promotion of market integrity and economic efficiency by guaranteeing investor confidence in securities markets and ensuring equal access to relevant information.[4] However, enforcing the insider trading provisions is extremely difficult, due to inherent problems with detecting insider trading and the fact that the insider trading provisions of the Act are 'devilishly difficult to construe'.[5] A key element of the offence which remains somewhat ambiguous is the 'possession' of inside information — specifically, whether physical possession or mere awareness, or both, is required.[6] In *Fysh v R* ('*Fysh*'),[7] the New South Wales Criminal Court of Appeal ('NSWCCA') provided some clarification on this issue by impliedly confirming that mere awareness will suffice.[8] This article argues in favour of the use of the subjective awareness test utilised in that case, despite the fact that it

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Industry and Managed Investments: Are We There Yet? The Journal of the Insider Trading Provisions' (2008) 26 *Company and Securities Law Journal* 460, 460.

3 *Corporations Act 2001* (Cth) pt 7.10 div 3.

4 *Mansfield v R* (2012) 247 CLR 86, 99 [45] (Hayne, Crennan, Kiefel and Bell JJ); House of Representatives Standing Committee on Legal and Constitutional Affairs, Commonwealth of Australia, *Fair Shares for All: Insider Trading in Australia* (1989) 13 [3.1.2]; Corporations and Markets Advisory Committee, Commonwealth of Australia, *Insider Trading Report* (2003) ii; Gill North, 'The Insider Trading Generally Available and Materiality Carve-Outs: Are They Achieving Their Aims?' (2009) 27 *Company and Securities Law Journal* 234, 234.

5 *R v Mansfield* (2011) 251 FLR 286, 289 (McLure P); *Corporations Act 2001* (Cth) pt 7.10 div 3; Ashley Black, 'Insider Trading and Market Misconduct' (2013) 29 *Companies and Securities Law Journal* 313, 313; Juliette Overland, 'Insider Trading, General Deterrence and the Penalties for Corporate Crime' (2015) 33 *Company and Securities Law Journal* 317, 321–2. Gill North, 'The Australian Insider Trading Regime: Workable or Hopelessly Complex?' (2009) 27 *Company and Securities Law Journal* 310, 310; See also *Ampolex Ltd v Perpetual Trustee Trading Co (Canberra) Ltd* (1996) 20 ACSR 649, 658 (Rolfe J).

6 Juliette Overland, 'The Possession and Materiality of Information in Insider Trading Cases' (2014) 32 *Company and Securities Law Journal* 353, 357; Overland, 'Re-evaluating the Elements of the Insider Trading Offence', above n 2, 262; O'Connell, above n 2, 460.

7 [2013] NSWCCA 284.

8 *He Kaw The v R* (1985) 157 CLR 523; Overland, 'Re-evaluating the Elements of the Insider Trading Offence', above n 2, 257.

is inconsistent with the generally accepted meaning of 'possession' in criminal law, and arguably imposes a higher evidentiary burden on the prosecution. In support of that position, this article discusses the facts and decision in *Fysh,* critically analyses the NSWCCA's interpretation of 'possession', and suggests some reforms to that element of the insider trading offence.

II THE CASE OF *FYSH v R*

Stuart Fysh was a senior business development executive at BG Group ('BG'), a global energy company engaged in liquefied natural gas ('LNG') projects. He was part of the senior management group of the company.[9] BG established a group called 'the Team' in 2006, comprising of senior employees, not including Fysh, to expand BG into the Asia-Pacific.[10] In June 2007, the Team identified Queensland Gas Company ('QGC') as a potential candidate for a takeover or merger.[11] QGC held substantial coal seam gas ('CSG') resources in Eastern Australia, which BG could use to produce LNG. Over subsequent months, Fysh received extensive correspondence from the Team relating to various takeover proposals with QGC.[12] During a meeting between Fysh and the Team in October 2007, a set of presentation slides were placed on a table for discussion.[13] These slides contained the Team's evaluation of QGC's Net Asset Value at more than 2.5 times its then current share price ('NAV information').[14] Evidence was conflicting about whether Fysh examined these slides or if they were discussed during the meeting.[15]

In December 2007, Fysh instructed his stockbroker to purchase 250 000 QGC shares at approximately $3.20 per share.[16] Subsequently, in February 2008, BG and QGC announced to the ASX that BG was acquiring a 9.9 per cent shareholding in QGC, direct ownership of 30 per cent of QGC's CSG assets and that QGC held very significant CSG reserves and contingent resources.[17] In October 2008, BG

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9 *Fysh v R* [2013] NSWCCA 284 [18]–[19] (Hoeben CJ at CL).
10 Ibid [21] (Hoeben CJ at CL).
11 Ibid [19]–[23] (Hoeben CJ at CL).
12 Ibid [27]–[33] (Hoeben CJ at CL).
13 Ibid [67] (Hoeben CJ at CL).
14 Ibid [12] (Hoeben CJ at CL).
15 Ibid [42]–[130] (Hoeben CJ at CL)
16 Ibid [34] (Hoeben CJ at CL).
17 Ibid [40] (Hoeben CJ at CL).

announced a takeover offer for QGC at $5.75 per share and Fysh made a $640,000 profit after selling his entire QGC holding for this price.[18] The Crown commenced proceedings against Fysh, alleging he possessed several pieces of inside information when he purchased the QGC shares, including the NAV information. In November 2012, a jury found Fysh guilty of two counts of insider trading, and he was sentenced to three and a half years' imprisonment.[19]

On appeal to the NSWCCA, Fysh's convictions were overturned.[20] In considering the issue of 'possession', the Court held that it was unreasonable for the jury to find beyond reasonable doubt that Fysh possessed the important NAV information.[21] This was because the evidence left reasonable doubt as to whether Fysh examined the presentation slides containing the NAV information, or whether they were discussed during the meeting.[22] The Court also confirmed that it was not necessary to prove that Fysh possessed *all* of the information alleged by the Crown to be in his possession. Instead, the test is whether the accused person possessed the *substance* of that information, taken as a whole or in combination, except any part of the information that makes 'no real difference'.[23] The NSWCCA held that it was unreasonable for the jury at trial to conclude that the NAV information made 'no real difference' to the substance of the information, given that this information related to QGC's share price and gave the rest of the information allegedly possessed by Fysh a 'commercial flavour'.[24]

III THE MEANING OF 'POSSESSION' AFTER *FYSH*

Despite the fact that Fysh briefly had physical possession of, or access to, the presentation slides containing the NAV information during the meeting of 23 October, the NSWCCA rejected the Crown's claim that Fysh 'possessed' this inside information.[25] Hence, the judgment impliedly confirmed that mere physical

18 Ibid [41] (Hoeben CJ at CL).
19 *R v Fysh (No 4)* (2012) 92 ACSR 116.
20 *Fysh v R* [2013] NSWCCA 284.
21 Ibid [185] (Hoeben CJ at CL).
22 Ibid [186] (Hoeben CJ at CL).
23 Ibid [132] (Hoeben CJ at CL) (emphasis added).
24 Ibid [199] (Hoeben CJ at CL).
25 Ibid [185]–[190] (Hoeben CJ at CL).

possession, without 'awareness' of the content of the information, does not constitute possession for the purposes of the insider trading offence.[26] This decision is consistent with the construction of 'possession' in *R v Hannes* ('*Hannes*'),[27] which was the only previous authority to consider the meaning of 'possession' in the context of insider trading. In that case, one of Mr Hannes' grounds of appeal was that the trial judge erred by failing to direct the jury that the concept of 'possession' in the insider trading offence contained an element of awareness so that mere physical possession would be insufficient.[28] In dismissing that ground of appeal, Spigelman CJ confirmed that an element of awareness is necessary in order for information to be 'possessed' as there must be 'actual knowledge of the [relevant] information'.[29] Therefore, it appears that 'possession' has become synonymous with awareness or knowledge.[30]

In 2015, the Supreme Court of Western Australia considered the knowledge element of the insider trading offence — that the insider knows, or ought to have known, that the information was not generally available and would be price-sensitive.[31] Unfortunately for the purposes of this article, that case did not directly consider the possession element. However, Hall J held that the knowledge element of the insider trading offence relates to the *act of possession*, and not the point of sale.[32] Hence, this appears to indirectly support the element of 'awareness' as adopted in *Hannes* and *Fysh*, as it would be impossible for an insider to 'know or ought to [have] know[n]' that information in his or her possession was not generally available or price-sensitive without awareness or knowledge of the contents of the inside information.

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26 Ibid [186] (Hoeben CJ at CL); Overland, 'Insider Trading, General Deterrence and the Penalties for Corporate Crime', above n 5, 366.

27 (2000) 158 FLR 359.

28 Ibid [227] (Spigelman CJ).

29 Ibid 398; Juliette Overland, 'There was Movement at the Station for the Word had Passed Around: How Does a Company Possess Inside Information under Australian Insider Trading Laws?' (2006) 3 *Macquarie Journal of Business Law* 241, 244.

30 Gregory Lyon and Jean Du Plessis, *The Law of Insider Trading in Australia* (Federation Press, 2005) 23; Alex Steel, 'The True Identity of Australian Identity Theft Offences: A Measured Response or an Unjustified Status Offence?' (2010) 33 *University of New South Wales Law Journal* 503, 518.

31 *R v Farris* [2015] WASC 251.

32 Ibid [175] (Hall J) (emphasis added).

A key feature of note in *Fysh* is that the Court's construction of 'possession' appears inconsistent with other sections of the Act that also make use of that term, and with the generally accepted meaning of that term in the criminal law. Even though the terms 'possess' and 'possession' are not defined in the insider trading provisions,[33] pt 1.2 of the Act states that possession means 'a thing that is in a person's custody or under a person's control'.[34] Clearly, this definition does not refer to awareness. The provisions in pt 1.2 have effect 'for the purposes of this Act', except so far as the contrary intention appears.[35] It could be argued, on one hand, that information is not a 'thing', and so this definition is not useful in interpreting 'possession' in the insider trading provisions.[36] Conversely, it is arguable that this definition should apply, as there is nothing in the insider trading provisions to suggest that Parliament did not intend for the definition in pt 1.2 to apply. In addition, if this definition did not apply, it would create 'internal inconsistencies' in the Act, which would contribute to difficulties in interpreting the complex insider trading provisions.[37] This is concerning, given that these provisions create serious criminal offences.[38]

In the landmark case of *He Kaw Teh v R,*[39] the High Court confirmed that a finding of possession cannot be made in the context of a criminal offence unless it can be proven that the accused had physical possession *and* a degree of knowledge or awareness.[40] As explained by Steel, giving a word a different meaning in a different context is contrary to the rule of law, as legal terms should have a single meaning.[41] Hence, the NSWCCA's decision is contentious, as its construction of 'possession' is inconsistent with that term's previously well-settled meaning.

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33 *Corporations Act 2001* (Cth) pt 7.10 div 3.

34 Ibid s 86.

35 Ibid s 6.

36 O'Connell, above n 2; Overland, 'There was Movement at the Station for the Word had Passed Around', above n 29, 244.

37 Ampolex Ltd v Perpetual Trustee Trading Co (Canberra) Ltd (1996) 20 ACSR 649, 658 (Rolfe J).

38 Ibid.

39 (1985) 157 CLR 523.

40 (1985) 157 CLR 523, 564 (Brennan J), 601 (Dawson J) (emphasis added); *Moors v Burke* (1919) 26 CLR 265, 271 (Isaacs, Gavan Duffy and Rich JJ).

41 Steel, above n 30, 523.

IV THE SUBJECTIVE AWARENESS TEST FOR 'POSSESSION'

Another consequence of the decision in *Fysh* is that the subjective awareness test adopted by the NSWCCA has thwarted the insider trading offence with difficulties of proof.[42] The test imposes a considerable evidentiary burden on the prosecution, as courts cannot look into the minds of insider traders to see whether or not they were aware of the inside information.[43] This was clear, as Fysh was acquitted on the basis that it could not be proven beyond reasonable doubt that he possessed the NAV information. As a result, an accused can somewhat easily avoid liability by claiming that they did not have awareness or knowledge of the contents of the inside information — even if they had physical possession. It is clear from *Fysh* that an objective physical possession test would have imposed a lesser evidentiary burden on the prosecution. Nonetheless, the subjective awareness test adopted in *Fysh* is still not as onerous as the requirement in some jurisdictions, such as the United Kingdom, where the prosecution must prove that an insider *used* the inside information when trading in affected securities.[44]

Despite the consequences of the subjective awareness test adopted in *Fysh*, this article argues that test should still be preferred over an objective physical possession test. There are several reasons for this. Firstly, the construction utilised by the NSWCCA is consistent with previous case authority,[45] which provides some certainty that 'possession' is synonymous with awareness for the purposes of the insider trading offence. Secondly, it would be virtually impossible for the prosecution to prove the other elements of the insider trading offence — that the insider knew, or ought to have known, that the information was not generally available and price-sensitive — if the insider had mere physical possession instead of an awareness of the

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42 Corporations and Markets Advisory Committee, Commonwealth of Australia, *Insider Trading: Discussion Paper* (2001) 33; *Colonial Mutual Life Assurance Society Ltd v Wilson Neill Ltd* (1994) 7 NZLR 152; Michael J Duffy, 'Insider Trading: Addressing the Continuing Problems of Proof' (2009) 23 *Australian Journal of Corporate Law* 149.

43 Hui Huang, *International Securities Markets: Insider Trading Law in China* (Kluwer Law International, 2006) 224.

44 Corporations and Markets Advisory Committee, above n 42, 66.

45 *R v Hannes* (2000) 158 FLR 359.

nature, content or price significance of the information.[46] Thirdly, the notion of awareness is more appropriate than physical possession in the context of insider trading, due to the fact that inside information can exist in both tangible and non-tangible form. While inside information will often exist in physical documentary form, the courts have also acknowledged that this information can include electronic information stored on a computer or via email, or information verbally communicated between two or more persons.[47] Hence, the notion of awareness appears more compatible with the insider trading offence.[48] As highlighted by Clough, this emphasises the importance of 'crafting definitions to reflect the digital environment', rather than importing traditional meanings such as physical custody or control for 'possession' where it would be inappropriate to do so.[49] The objective physical possession test is problematic, as it is impossible to exercise physical control and custody over intangible information.

V SOLUTIONS: IMPROVING THE SUBJECTIVE AWARENESS TEST FOR POSSESION

In order to overcome the high evidentiary burden of the subjective awareness test, courts might consider implying a rebuttable presumption that directors and other senior managers of a company *possess* information that is generated within, or was otherwise known to, that company.[50] This presumption would place a higher level of accountability on senior officers, as persons in those roles are likely to have the privilege of access to sensitive internal

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46 Overland, 'The Possession and Materiality of Information in Insider Trading Cases', above n 6; Corporations and Markets Advisory Committee, above n 42, 63.

47 *Mansfield v R* (2012) 247 CLR 86; *Fysh v R* [2013] NSWCCA 284; Overland, 'There was Movement at the Station for the Word had Passed Around', above n 29, 243–4; Juliette Overland, 'What is Inside "Information"? Clarifying the Ambit of Insider Trading Laws' (2013) 31 *Company and Securities Law Journal* 189, 189.

48 Steel, above n 30, 523.

49 Jonathan Clough, 'Now You See It, Now You Don't: Digital Images and the Meaning of Possession' (2008) 19 *Criminal Law Forum* 205, 210.

50 Huang, above n 43; Corporations and Markets Advisory Committee, Commonwealth of Australia, above n 42, 66; *Tribunal de Grande Instance de Paris*, 3 December l993, *Gazette du Palais*, 27–28 May 1994, pp 28 ff.

information about the company's affairs by virtue of their positions.[51] If this approach was applied in the case of *Fysh,* Mr Fysh would have faced the more onerous burden of rebutting the awareness presumption — which may have resulted in his convictions being upheld on appeal. In 2002, the Corporations and Markets Advisory Committee ('CAMAC') advised against introducing this presumption, as it would impose considerable evidential problems on defendants in proving the absence of awareness.[52] However, given the importance of market fairness and efficiency, and the principles that underpin the prohibition on insider trading,[53] it is argued that this onerous burden imposed on defendants is justified. Seeing as instances of insider trading are increasing,[54] and prosecuting the offence is hindered by difficulties with adducing proof of the offence,[55] any reform which would promote due diligence of directors and senior management to fully inform themselves about whether information is generally available and price-sensitive before trading in securities should be welcomed. This will also help to overcome the prevailing view in corporate circles that insider trading is under-prosecuted and under-detected.[56]

Another possible solution to partially overcome the inherent difficulties with respect to proof of subjective awareness is to make it more attractive for prosecutors to commence civil proceedings against alleged insider traders. This is because the burden of proof in civil proceedings is 'on the balance of probabilities' rather than

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51 Huang, above n 43; Corporations and Markets Advisory Committee, Commonwealth of Australia, *Aspects of Market Integrity* (2009) 90.

52 Corporations and Markets Advisory Committee, Commonwealth of Australia, *Insider Trading: Proposals Paper* (2002) 31–2.

53 Simon Rubenstein, 'The Regulation and Prosecution of Insider Trading in Australia: Towards Civil Penalty Sanctions for Insider Trading' (2002) 20 *Company and Securities Law Journal* 89, 99.

54 Peter Hunt, Chairman of Caliburn Partnership, as reported in Michael West, 'Insider Trading Still on the Rise' *Sydney Morning Herald* (online), 20 February 2008 <http://www.smh.com.au/business/insider-trading-still-on-the-rise-banker-20080219-1t45.html>; Professor Ian Ramsay, Director of the Centre for Corporate Law and Securities Regulation, as reported in Vanessa Burrows, 'ASIC on Insider Trading Hunt' *The Age* (online), 12 March 2008 <http://www.smh.com.au/business/asic-on-insider-trading-hunt-20080311-1yqv.html>.

55 Duffy, above n 42; 'Insider Trading, General Deterrence and the Penalties for Corporate Crime', above n 5, 317; Overland, 'What is Inside "Information"?', above n 47, 189.

56 Juliette Overland, 'What is Inside "Information"?', above n 47, 189.

'beyond reasonable doubt'.[57] Although the insider trading offence in Australia attracts both criminal and civil penalties,[58] the Australian Securities and Investment Commission generally pursues criminal action given the seriousness of this conduct.[59] In terms of criminal penalties, the maximum prison term and fines are comparable to many other jurisdictions.[60] In contrast, the civil penalties in Australia, currently a maximum of $200 000 for individuals,[61] are significantly less than those imposed in other jurisdictions.[62] In situations where there is insufficient evidence of proof of insider trading beyond reasonable doubt, such as in *Fysh,* it would be more appropriate to pursue civil action. However, this is unattractive given the inadequate penalties. If civil penalties were higher, it may have been appealing to pursue civil action against Mr Fysh, and it would have been very likely that a court would find that, on the balance of probabilities, Mr Fysh possessed the NAV information. In this case, Mr Fysh could have still faced a significant fine if these penalties were aligned to those in other jurisdictions.

VI CONCLUSION

After *Fysh,* it appears settled that the element of 'possession' in the insider trading offence imports a notion of awareness, and mere physical possession is insufficient. This article argues that this construction is the most appropriate in the context of insider trading, despite the fact that the alternative objective possession test imports a lesser evidentiary burden. However, it should be noted that both *Hannes* and *Fysh* were handed down in the NSWCCA, and thus it is not uncontestable that 'possession' is synonymous with 'awareness' — it remains to be seen whether the High Court will agree with that interpretation. Given that insider trading has historically offered very limited opportunities for judicial consideration, Parliament could

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57 Duffy, above n 42, 153.

58 *Corporations Act 2001* (Cth) s 1043A.

59 Australian Securities and Investments Commission, Commonwealth of Australia, *Report 387: Penalties for Corporate Wrongdoing* (2014) 25.

60 Ibid 16; *Corporations Act 2001* (Cth) s 1311(1).

61 *Corporations Act 2001* (Cth) ss 1043A, 1317E, 1317G.

62 This includes a fine up to $1 million in Canada, unlimited fines in the United Kingdom and Hong Kong, and a fine up to 3 times the benefit gained in the United States. See Australian Securities and Investments Commission, above n 59, 25–6.

consider amending ‘possession’ to ‘awareness’ or ‘knowledge’ in order to eliminate the ambiguity surrounding this element. Unfortunately, this amendment would not eliminate the onerous evidentiary burden of the subjective awareness test, which was highlighted in *Fysh*, as the prosecution could not establish beyond reasonable doubt that Fysh possessed the inside information, despite the compelling evidence that he had physical possession. Therefore, it is further recommended that a fresh review be undertaken regarding whether a rebuttable presumption of ‘awareness’ against directors and senior managers in certain circumstances could be introduced in order to place the onus on these senior officers. The fact that Mr Fysh avoided any penalties for his conduct undermines public confidence in the Australian securities market, as it cannot be assured that directors and other senior managers will be made accountable for their actions. A rebuttable ‘awareness’ presumption, or at least harsher civil penalties, should be introduced to ensure that the insider trading offence fulfills its purpose of promoting market integrity and economic efficiency.