LEGAL BRIEFING
JUNE 2014

Upper Tribunal finds against Ian Hannam

Lessons for listed companies and their financial advisers

- Clarifies the "reasonable investor" test for price sensitive information
- Approves an expansive view of the right to delay announcements
- Establishes "realistic prospect" as the test for prospective information

SUMMARY

The Upper Tribunal has handed down its judgment in the case of Ian Hannam v FCA, finding that Mr Hannam committed market abuse by disclosing inside information improperly. The Tribunal has not yet made a decision on the appropriate penalty (in 2012 the FCA decided to impose a financial penalty of £450,000). Overall, the FCA will be pleased with its victory but perhaps disappointed that many of the hard line positions it took in its Decision Notice were not upheld (some it abandoned before it presented its case to the Tribunal).

The judgment contains some important comments on the meaning of inside information:

- the FCA's position that the "reasonable investor" test is an exhaustive test of price sensitivity is rejected: the likely (i.e., "real prospect") effect on price must be taken into account in applying the reasonable investor test
- the test to be applied to information about something that may come about in the future is whether there is a "realistic prospect" of that thing occurring
- inaccuracies in information disclosed do not prevent that information (so far as it is accurate) from being inside information

The judgment also addresses the scope of the ability to delay announcement of inside information:

- the Tribunal accepted that a listed company could delay in order to allow for a period of verification to ensure that when an announcement is made it is not misleading or to finalise its financial results (absent exceptional circumstances)

The overall result, based on the Tribunal's analysis, is that listed companies will find that information about future events is more likely to be regarded as inside information but that will be balanced against a broader view of the ability to delay announcements. This should be a satisfactory result that does not lead to more announcements having to be made. The FCA should issue updated guidance to reflect the Tribunal's decision.

On the scope of the "improper disclosure" head of market abuse, the Tribunal has adopted a restrictive approach that is likely to lead financial advisers (and listed companies) to adopt more rigorous policies where information that may be inside information is to be disclosed:

- information that may be inside information must be handled with great care
- recipients should be subject to express confidentiality obligations and understand that the information is (or may be) inside information
- breach of the Takeover Code restrictions on disclosing information about a prospective bid

will result in that disclosure amounting to market abuse by the individual concerned

- sending inside information to the wrong people by mistake amounts to market abuse
- a listed company can decide to disclose (or authorise its financial advisers to disclose) inside information where to do so is a proportionate and reasonable way of achieving its commercial objectives

It is also worth noting that the Tribunal confirmed that the standard of proof in cases of market abuse is the normal civil standard of a "balance of probabilities" and not the higher standard of "beyond reasonable doubt" applicable in criminal cases.

THE FACTS

The FCA case against Mr Hannam related to two emails sent in September and October 2008 to Dr Hawrami, the Oil minister in the Kurdistan Regional Government, in relation to Mr Hannam's client, Heritage Oil. The key elements of the emails were:

- 9 September: "*I thought I would update you on discussions that have been going on with a potential acquirer of Tony Buckingham's business. Tony, advised by myself, has deferred engaging with the client until Thursday of next week although we know they are very excited about the recent drilling results of Heritage Oil and today's announcement by Tullow. I believe that the offer will come in in the current difficult market conditions at £3.50 - £4.00 per share.*"
- 8 October: "*PS – Tony [Buckingham] has just found oil and it is looking good.*"

THE FCA PROCEEDINGS

In April 2012, the FSA announced that it had decided to fine Mr Hannam, a senior investment banker, for improper disclosure of inside information. The FSA concluded that the communication of each of the two emails amounted to market abuse, because they each involved a disclosure of inside information that, in the FSA's view, was not made in the proper course of the exercise of Mr Hannam's employment, profession or duties.

The sanction imposed was a fine of £450,000. In comparison to previous fines for market abuse, this is a large fine for a case where the FSA accepts that no dealing took place and no profit was made from the abuse. According to the FSA, this reflected the seriousness of the breach and Mr Hannam's position as a senior and experienced banker. The fine was reduced by a number of mitigating factors, including:

- Mr Hannam did not know the information was inside information when he disclosed it (and did not intend or expect the information to be abused)
- there was no abusive dealing
- Mr Hannam did not act without honesty or integrity (and his status as an approved person was not challenged)

THE REFERENCE TO THE TRIBUNAL

Mr Hannam took the unusual step of referring the matter to the Upper Tribunal. He explained his position as follows:

"*I do not believe that I broke the rules on inside information. On the contrary, I was acting in the proper course of my employment as a corporate financier, pursuing a transaction on behalf of my client. … The case raises questions about the definition, and treatment of, inside information on the corporate finance side of the "Chinese Wall" and clarification by the Upper Tribunal is important for London as a global financial centre.*"

The Tribunal judgment contains a detailed analysis of a number of issues. It is clear that the submissions made to it by counsel for Mr Hannam and the FCA were long and detailed. As a result this decision contains the first thorough judicial assessment of a number of difficult points relating to the definition of inside information.

THE "*REASONABLE INVESTOR*" TEST AND PRICE SENSITIVITY

The FCA's position has been up to now that the "reasonable investor" test provides an exhaustive definition of when information is inside information. The Tribunal did not agree. It regarded the likely effect on the price of listed securities as something to be taken into account in assessing whether a reasonable investor would use the information for its investment decisions. The Tribunal also held that the information must be such that it is possible to predict the direction of the price movement.

The Tribunal took the view that for the purposes of judging the price effect of information, "likely" means that there must be a real (and not fanciful) prospect of the information having an effect on the price of the securities (and the same must apply to the likelihood of it being used by a reasonable investor). The Tribunal rejected the argument that "likely" meant "more probable than not" or "may well".

Comment

While we might have hoped the Tribunal would have supported the proposition that the reasonable investor test is an additional condition and not a substitute for a judgment on the likely price effect, at least the Tribunal has rejected the simplistic approach of the FCA. It appears, therefore, that information that is not likely to move the price appreciably will not be inside information even though it might be relevant to a reasonable investor. The amount of the potential price effect that is required is something more than "trivial" but we should be cautious about relying on "significant" in this context (the Tribunal steered away from a quantative approach). The "real prospect" test for what is "likely" is unhelpful but in our experience judgments are not in practice made on finely judged probabilities. Overall, we do not think decisions made by listed companies about inside information will be much affected. We also think the Tribunal's approach should be equally applicable when the Market Abuse Regulation comes into force (July 2016).

PROSPECTIVE EVENTS AND PRICE SENSITIVITY

In relation to information about things that have not yet occurred the Tribunal considered what was meant by events "reasonably expected to occur". It concluded that this did not mean "more likely than not" but rather that there must be a "realistic prospect" of those events occurring. In reaching this conclusion the Tribunal followed comments made in a decision by the ECJ in the *Geltl* case[1].

Comment

Many companies have disclosure policies that adopt the "more likely than not" test as the rule of thumb for determining whether there is inside information which may have to be disclosed. That test must now be regarded as unsafe and policies should be changed to use the test of whether there is a "realistic prospect" of the event in question coming about. We can see the merit in this approach in the context of judging whether insider dealing has taken place (or an improper disclosure has been made) and many companies will in practice have taken a cautious view of what may be reasonably expected to occur, when deciding whether to allow dealings. But in relation to disclosure obligations this approach potentially expands the scope of uncertain future events that could amount to inside information. This may, however, be mitigated by the broader view of the ability to delay (as to which see below), leading on balance to an acceptable position for listed companies considering their disclosure obligations.

INACCURATE INFORMATION

One of the issues in the case related to whether the October email was accurate in stating that oil had been found. Without going into the technical details (discussed at great length in the judgment), the Tribunal's conclusion was that this statement was not wholly accurate but nor was it wholly inaccurate (in which case it could not have been inside information) and it therefore fell to the Tribunal to discern whether

1 *Geltl v Daimler* C-19/11 [2012] 3 CMLR 762

the accurate elements (that there had been positive results from drilling that were encouraging) was inside information. The Tribunal found that it was.

Comment

The Tribunal's position is unsurprising and makes sense in the context of insider dealing (and disclosure of inside information). It will not often be relevant to companies' decisions on announcements.

INFORMATION THAT CONFIRMS A GENERALLY HELD VIEW MAY BE INSIDE INFORMATION

It was argued for Mr Hannam that the information in the October email concerning the oil find was not inside information because it was merely confirming a view (that there were good prospects for the block where the drilling was taking place) that was generally understood.

Comment

This was a matter of fact and therefore of limited value in assessing how the law should be applied but it is interesting to note that the Tribunal had little difficulty accepting that information that tended to confirm a general expectation could be inside information. This follows the approach of the Tribunal in the case of *Massey v FSA* (2011).

THE RIGHT TO DELAY – "LEGITIMATE INTERESTS" CLARIFIED

It comes as a surprise to learn that in its case to the Tribunal the FCA argued that Heritage was within its rights to delay disclosure of the inside information regarding the drilling results on the basis that it was necessary to do so to protect its legitimate interests. Specifically the expert witness for the FCA asserted that such a delay was standard industry practice (and therefore legitimised). This contrasts distinctly with the published position of the FCA that seeks to limit the scope of the ability to delay to the bare minimum "*… the FCA considers that, other than in relation to impending developments or matters described in DTR 2.5.3 R or DTR 2.5.5A R, there are unlikely to be other circumstances where delay would be justified*" (DTR 2.5.5 G).

The point arose because counsel for Mr Hannam argued that the FCA's failure to take any action against Heritage for not announcing the drilling results indicated that it did not view the information about those results as inside information. To meet this argument the FCA had to take the position that the information was inside information but Heritage was entitled to delay announcement.

The Tribunal rejected the argument made on behalf of the FCA that an industry practice could justify delay but held that it was reasonable for Heritage to delay announcement of the drilling results until it could provide information that avoided the risk of misleading the market. Although the drilling results at the time of the October email gave considerable confidence that oil was present they were not definitive and Heritage was entitled to delay the announcement until more definitive results were available. The Tribunal commented on the usual practice of listed companies delaying announcement of their results until the planned publication date. The Tribunal assumed that results information was inside information but said that "*unless there is some exceptional event or fact that requires immediate disclosure*" a listed company can reasonably delay announcing until the reporting date.

Comment

We see this as potentially significant. The existing guidance (DTR 2.2.9G(2)) is unhelpful and unrealistic:

"*If an issuer is faced with an unexpected and significant event, a short delay may be acceptable if it is necessary to clarify the situation. In such situations a holding announcement should be used where an issuer believes that there is a danger of inside information leaking before the facts and their impact can be confirmed…*" (DTR 2.2.9 G (2)).

Often, as a result, companies faced with an uncertain position feel forced into an early announcement that is both bad for the company and risks misleading the market. The Tribunal's decision opens the way for a more rational and sensible approach. We believe

the FCA should modify its guidance accordingly. The FCA may be reluctant to do so but, set against the case it made to the Tribunal, a refusal should not be sustainable.

DISCLOSURE OF INFORMATION IN "THE PROPER COURSE OF EMPLOYMENT"

The Tribunal placed considerable emphasis on the FCA's guidance in MAR 1.4.5(2) in its consideration of whether the disclosure of inside information by Mr Hannam was in the proper course of his employment. It attached great importance to the requirement for the imposition of a duty of confidentiality and expressed considerable scepticism (without ruling out the possibility) about whether an implied or understood duty of confidentiality would be sufficient. Another requirement of MAR 1.4.5(2) is that the disclosure must be reasonable. The Tribunal does not provide much assistance with that requirement save to indicate that the disclosure must be a "*reasonable or proportionate way of achieving the objective …*". The Tribunal does make it clear that it will rarely, if ever, be reasonable to disclose information in breach of Rule 2 of the Takeover Code (i.e., to disclose information regarding a prospective takeover bid).

The Tribunal calls on the FCA to consider whether authorised firms should be required to keep records of "*when and how a person has been made subject to confidentiality obligations and of precisely what he has been told*". Whether or not the FCA takes this up, we can expect financial advisers to adopt more rigorous processes in the future.

Comment

We expect that listed companies and financial advisers will review their policies and procedures on the disclosure of information that may be inside information and would recommend that wherever possible written acknowledgement of the confidentiality and status as an insider restricted from dealing (or disclosing) be obtained. There is no requirement for this to be in writing, but the Tribunal showed significant scepticism of informal arrangements. Another benefit of formalised procedures for the assessment of whether information is inside information and whether it is appropriate to disclose will be to enhance the availability of the defence in s.123(2) FSMA (belief on reasonable grounds that the relevant behaviour was not market abuse). Mr Hannam could not avail himself of this defence as there was no evidence he had addressed his mind to the question.

SELECTIVE DISCLOSURE OF INSIDE INFORMATION

The Tribunal acknowledged that DTR 2.5.7G provides for selective disclosure by listed companies, subject to limitations, and referred to MAR 1.4.5(2) for clarification of the constraints on such disclosure. The Tribunal did not support the more extravagant claims of the FCA in its Decision Notice that disclosure could not be justified as it was "*purely in furtherance of [Heritage's] commercial interests*".

Comment

The Tribunal's decision has returned us to the position before the Decision Notice was published, that is, that a listed company is entitled, within the bounds of what is reasonable and proportionate to achieve its objective, to determine to whom its inside information may be disclosed.

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