TRAVERS SMITH

Regulatory Investigations Group

Ian Charles Hannam v The Financial Conduct Authority
Inside information clarified?

In its decision in *Ian Charles Hannam v The Financial Conduct Authority*[1], the Upper Tribunal (the "Tribunal") provided some highly anticipated and much needed clarification on the definition, and treatment, of inside information. Reflecting the complexity and importance of the case, the 130 page judgment will undoubtedly have repercussions throughout the financial services sector and serve as a precedent for future cases involving allegations of improper disclosure of inside information.

The case focused only on the improper disclosure of inside information and did not consider the possibly wider concept of 'relevant information' which is relevant in some other market abuse cases.

Background

In a Decision Notice dated 27 February 2012, the FSA, whose conduct responsibilities have since been devolved to the Financial Conduct Authority[2], fined Mr Hannam, a senior banker at J.P. Morgan and approved person (CF 30), £450,000 for improperly disclosing inside information contrary to s118(3) of the Financial Services and Markets Act ("FSMA") in two emails sent on 9 September 2008 (the "September email") and 8 October 2008 (the "October email") respectively.

Improper disclosure is conduct where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties.

Mr Hannam referred the matter to the Upper Tribunal which handed down its decision on 27 May 2014.

The FSA alleged that the emails contained inside information relating to Heritage Oil Plc ("Heritage"), a listed oil and gas exploration and production company and a client of J.P. Morgan for which Mr Hannam was the lead corporate adviser (and had been since January 2007). At the time, Heritage's CEO was Mr Tony Buckingham, with whom Mr Hannam maintained a close professional relationship.

In the September email, Mr Hannam stated: *"I thought I would update you on discussions that have been going on with a potential acquirer of [Heritage]. Tony [Buckingham], 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] and today's announcement by Tullow [which contained positive news about a field near to one being drilled by Heritage]. I believe that the offer will come in in the current difficult market conditions at £3.50 - £4.00 per share"*. The October email contained a post-script stating: "*PS - Tony [Buckingham] has just found oil and it is looking good*". These emails were sent by Mr Hannam at a time when he knew that at least one of the recipients of the emails represented an organisation that was interested in investing in a company like Heritage. Mr Hannam admitted that the purpose of the emails was to develop the recipient's interest in the proposed transaction and ultimately to "broker a deal".

It was recognised by the FSA at the outset that Mr Hannam did not disclose the information in the September email and the October email with the intention or expectation that the information would be abused and he did not act without honesty or integrity in making the disclosures. Nor was there any evidence that anyone dealt in shares as a result of Mr Hannam's disclosures or that he made any personal gain as a result.

The Tribunal's decision

The Tribunal considered whether the emails contained inside information for the purposes of FSMA, and found that they did. It then considered whether that inside information was disclosed in the proper course of Mr Hannam's employment and concluded that it had not been. It also considered whether Mr Hannam had a defence under section 123 FSMA, namely that the FSA had reasonable grounds to be satisfied that he believed (also on reasonable grounds) that his behaviour did not amount to engaging in market abuse and concluded that he did not. Accordingly, the Tribunal concluded that the FSA had successfully established its case that Mr Hannam had committed market abuse contrary to s118(3) FSMA. The parties were invited to make further submissions on the question of penalties which will be decided in due course.

What is inside information?

For information to be "inside information" for the purpose of s118C(2) FSMA it must, amongst other things,

- be **of a precise nature**; and
- be information that would, if generally available, **be likely to have a significant effect on the price** of the qualifying investments or on the price of related investments.

[1] [2014] UKUT 0233 (TCC)

[2] For convenience, reference is made to the "FSA" throughout this note.

Precise

Pursuant to s118C(5)(a) and (b) FSMA, information is "precise" for these purposes if it (a) **indicates circumstances** that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur; and (b) is specific enough to enable a conclusion to be drawn as to **the possible effect** of those circumstances or that event **on the price** of qualifying investments or related investments.

The Tribunal considered that the question of whether information was precise gave rise to a number of issues:

(1) **The extent to which information must be accurate in order to be sufficiently precise to constitute inside information.** The Tribunal concluded that information which is not wholly accurate may, nonetheless, convey a message to the recipient which may give the recipient an advantage over other market participants and is therefore capable of amounting to inside information notwithstanding its inaccuracy. Whether or not it will do so will be highly fact dependent and it will be critical to determine what message the particular statement conveys. This will be assessed objectively, and not by reference to the understanding or knowledge of the particular recipient. The Tribunal considered that the correct approach was to establish what existing circumstances or past or future events are indicated by the information taken as a whole and then to establish whether those circumstances/events are proved as having actually existed/occurred or, in the case of future circumstances/events, whether there is a" realistic prospect" that they will come into existence or occur. The Tribunal considered that "realistic prospect" means more than fanciful, but not necessarily more likely than not.

(2) **The meaning of "possible effect"**, in the context of the requirement that information should be specific enough to enable a conclusion to be drawn as to the possible effect on price and in particular whether the possible effect is as to a movement in price in a particular direction (i.e. up or down) or a mere movement. The Tribunal found that it was necessary for the information to indicate the direction of movement but not the extent to which the price might be affected. The information does not have to be such as to enable an investor to know *with confidence* that the price *will* move if the information were made public.

Likely to have a significant effect on price

(1) **The interaction between the "price" and "reasonable investor" tests.** S118C(2)(c) FSMA introduces the requirement that the information in question would, if generally available, be *likely to have a significant effect on the price* of the relevant securities and s118C(6) provides that information would be likely to have a significant effect on price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions. The Tribunal considered the reasonable investor test in s118C(6) to provide the definition of what would be likely to have a significant effect on price for the purposes of s118C(2)(c), but that the definition must be applied in the context of the price test. In particular, it said that *"the reasonable investor is an investor who would take into account information which would be likely to have a significant effect on price. Conversely, he is an investor who would not take into account information which would have no effect on price at all . . . "*. This contrasts with previous decisions where it had been found that no expected price effect was required and that, in effect, the reasonable investor test replaced the price test (for example, in the *Massey* case[3], in relation to which the Tribunal in the Hannam case merely commented *"it is not at all clear to us why the tribunal [in Massey] put the matter the way it did . . ."*).

(2) **The meaning of significant.** The Tribunal found that "significant" for these purposes was to be contrasted with insignificant in the sense of trivial. Beyond that, the Tribunal declined to attempt to postulate any quantitative approach to determine what constitutes a "significant" effect for these purposes.

(3) As to **the meaning of "likely"**, the Tribunal found that information which was "likely" to have a significant effect on price was information where there was a real (and not fanciful or *de minimis*) prospect of the information having an effect on the price of qualifying investments. It does not need to be more likely than not.

The Tribunal noted that it "*found it very difficult to arrive at an interpretation of section 118C which gives a wholly satisfactory answer to what is and what is not "inside information"*. As such, it is clear that any decision as to whether information is "inside information" will remain heavily fact dependent. However, the Tribunal expressed the hope that the approach taken will *"provide a sensible answer in the vast majority of situations"*.

Other issues

The Tribunal addressed some additional issues of interest, including the following.

- The provisions must be construed in the context of the purpose of the legislation, which, in relation to the identification of inside information, is to identify information which would provide the recipient with an advantage over other market participants.
- The Tribunal considered the extent to which the expression of a view or opinion could be information relating to an event or circumstance and therefore constitute inside information. It found that it could. It considered this in the context of whether some of the statements made in the emails were “spin”. In relation to whether, on the particular facts, the statements of opinion contained in the emails were incorrect, the Tribunal added that Mr Hannam would not be able to take advantage of a lie to say that he was not disclosing information (i.e. about his own state of mind) at all. This is relevant to the extent to which information must be accurate in order to constitute inside information (see above).
- It was argued that the communication of information to an individual who was already in possession of the information could not be an improper disclosure of inside information because there was no “disclosure”. This argument was rejected on a number of grounds, including (i) the prohibition on disclosing inside information does not include any indication that the person disclosing the information must know or believe that the recipient does not have the information already; (ii) repetition

[3] Massey v FSA [2011] UKUT 49 (TCC)

of the information may lend credence to it; and (iii) the focus of the legislation is on what the insider is doing and not on what the recipient does and does not already know.

- The Tribunal re-affirmed that there is no difference in the concept of inside information when used in the context of an issuer's obligations to disclose inside information promptly and publicly (unless a specific exemption applies) and when used in the context of the improper disclosure and insider dealing offences.

Application of the principles to the facts of the case

Taking all the above into account, the Tribunal determined that:

- The September email contained a number of pieces of information about circumstances which existed or events which might reasonably be expected to occur. The Tribunal considered at some length whether an offer for Heritage was an event which might reasonably be expected to occur such that the statement that Mr Hannam believed that an offer for Heritage would come in was capable of being inside information. The Tribunal considered that on the evidence there was a reasonable prospect of an offer being made, notwithstanding that no offer would be made without satisfactory drilling data being obtained. The Tribunal considered that the reference to the figure of £3.50 to £4.00 per share did not detract from the message that an offer would be made and that Mr Hannam did believe that an offer would come in, even if the reference to £3.50 to £4.00 may have been "spin"; and if it was more than "spin" Mr Hannam would not be permitted to take advantage of his own lies to say that what was disclosed was not information at all.
- The information contained in the September email (to the extent it was accurate) was specific in that it enabled a conclusion to be drawn about the possible effect on price - it was not necessary to be told that a bid would be made. Moreover, the Tribunal considered that a reasonable investor would take account of the information in making his investment decisions and that the market would react in a way which produced a price rise. The information was thus "inside information" since there would, in fact, be a significant effect on price and the information would be such that a reasonable investor would use it in making his investment decisions.
- So far as the post-script to the October email is concerned, the Tribunal found that, notwithstanding that Mr Hannam's belief that black oil had been found was wrong, the post-script indicated circumstances which did exist, namely that there were strong indicators of black oil. The Tribunal found that the post-script to the October email also indicated that Mr Buckingham and Mr Hannam (or possibly only Mr Hannam) considered the finding to be positive news.
- The information contained in the post-script to the October email was also specific in that it might have an effect on Heritage's share price if made public and, if it were to do so, the direction of movement would be upwards. Moreover, it fell within s118C(5)(c) because there was a real prospect that if made generally available the information would have had a significant effect on the price of Heritage's shares.
- The Tribunal therefore concluded that the October email disclosed relevant information about the drilling results and about Mr Hannam's (and implicitly Mr Buckingham's) beliefs that the results were positive and that information was inside information.

Disclosure in the proper course of employment

The second question considered by the Tribunal was whether, if the emails did constitute inside information, Mr Hannam had disclosed them in the proper course of his employment. Mr Hannam sought to rely on the FSA's own guidance, found in MAR 1.4.5 which had evidential status and could therefore be relied upon to indicate whether or not particular behaviour should be taken to amount to market abuse. The guidance indicates that where a disclosure is accompanied by the imposition of confidentiality requirements upon the person to whom the disclosure is made and it is reasonable for the purpose of facilitating any commercial, financial or investment transaction this is evidence that the disclosure was made in the proper course of employment. Mr Hannam argued that the disclosures were made in the proper course of his employment given that both of the emails were sent: (i) in furtherance of Mr Hannam's mandate to facilitate a corporate transaction, (ii) with the implicit authority of his client, and (iii) on the understanding that the information was being received in confidence and would not be abused. However, the Tribunal disagreed.

The Tribunal found that:

- the ability to disclose inside information in the proper course of employment operates as an exception to the general requirement that inside information must not be disclosed and, as such, the exception must be interpreted narrowly;
- whilst the emails were sent in the course of Mr Hannam's employment, this did not mean that this was necessarily in the "proper" exercise of his employment;
- if disclosure was prohibited by the Takeover Code, that would clearly be relevant to whether disclosure was in the proper course of the exercise of employment; and
- it would never be in the proper course of a person's employment for him to disclose inside information to a third party where he knows that his employer and client would not consent to the public disclosure of that information.

The Tribunal found that the disclosure contained in the September email was a breach of the Takeover Code and that it was not within the proper scope of the exercise of Mr Hannam's employment to disclose information in breach of the Takeover Code. Even if that was not the case, the Tribunal found that the information disclosed in both the September and October emails could only be disclosed if the recipient was under an obligation of confidentiality, which was not satisfied in the present case. A mere understanding on the part of the recipient of the need to keep information confidential (had it existed) was insufficient to impose a confidentiality obligation.

Section 123(2) FSMA Defence

If the FSA found that Mr Hannam had not acted in the proper course of his employment, Mr Hannam submitted that he had a defence under s123(2)(a) FSMA, namely (i) that he believed on reasonable grounds that he was not engaging in market abuse and (ii) the FSA had reasonable grounds to be satisfied that he believed this. This was rejected by the Tribunal. The defence required Mr Hannam to show that he believed that he was not engaging in market abuse and that that belief was reasonable. The Tribunal identified two bases upon which Mr Hannam might argue that he believed that his behaviour did not amount to market abuse, namely that (i) he reasonably believed that the emails did not contain inside information or (ii) he reasonably believed that the emails were not disclosures of inside information other than in the proper course of the exercise of his employment (either because they were not disclosures because the recipient already knew the information or because the disclosures were in the proper course of the exercise of his employment).

As to the September email, Mr Hannam did not adduce any evidence that he consciously believed at the time that the information was not inside information. The Tribunal found that a reasonable adviser in Mr Hannam's position would have thought about it and that it was not enough for Mr Hannam to say that, had he thought about it, he would have concluded, or it would have been reasonable to conclude, that the email did not contain inside information. Moreover, the Tribunal found that, given that he believed that the contents of the email were true, Mr Hannam could not reasonably have formed the view that what he was doing was anything other than to communicate inside information. Moreover, had the September email been accurate, it may have been that the information should not have been disclosed on the basis that it was not necessary (within the meaning of the Takeover Code) to do so and even then the Tribunal was clear that the information could not have been disclosed without ensuring that the recipient was subject to strict confidentiality.

Similarly, in relation to the October email, there was no evidence that Mr Hannam had thought about whether the email contained inside information and it was not sufficient for him to say that, had he done so, he would have concluded that it did not or that it would have been reasonable for him to do so. Moreover, since Mr Hannam believed that black oil had been found, he could not reasonably have considered that he was not communicating inside information. Nor could Mr Hannam have reasonably believed that he could in the proper course and exercise of his employment disclose a finding of black oil without ensuring that appropriate confidentiality obligations were in place.

Standard of proof

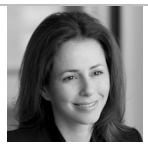
The FSA accepted that it had the burden to establish that Mr Hannam was guilty of market abuse on the evidence put before the Tribunal. Although Mr Hannam attempted to argue that the allegations that had been put to him were "*tantamount to allegations which constitute criminal offences*", the Tribunal held that the standard of proof for market abuse cases is the civil standard i.e. whether it is more likely than not that what is alleged in fact occurred. It was noted that the mental element for similar criminal offences is wholly absent from the market abuse provisions under consideration and that there is no justification to entitle the same level of protection to someone accused of market abuse as to a person whose fundamental liberties are at risk.

Important practical steps

The case covers some important issues which need to be reflected in practice. Firms should therefore be considering a number of steps, including:

- updating their personnel in relation to the key messages to emerge from the case, whether in the form of training or a written update;
- engaging specifically with the teams who broker transactions to ensure that they understand the need to avoid communicating insider information (and also to avoid misleading communications). A mechanism for approving communications might be considered;
- reinforcing the need to impose confidentiality obligations before communicating inside information (as opposed, say, to relying on a hoped-for understanding that the circumstances demand confidentiality). This should be reflected in the procedures used for making an individual an insider;
- putting in place additional safeguards in potential bid scenarios since emphasis was placed on the need to comply with the Takeover Code;
- updating teams who advise issuer clients, given that the case underlined the parallel with the obligations of issuers to disclose inside information.

For further information on any of the issues discussed above, please contact any of the regulatory investigations partners named below.

	**Margaret Chamberlain, Partner and Co-head of RIG** T: +44 (0)20 7295 3233 margaret.chamberlain@traverssmith.com		**Stephen Paget-Brown, Partner and Co-head of RIG** T: +44 (0)20 7295 3223 stephen.paget-brown@traverssmith.com
	**Jane Tuckley, Partner** T: +44 (0)20 7295 3238 jane.tuckley@traverssmith.com		**Rob Fell, Partner** T: +44 (0)20 7295 3292 rob.fell@traverssmith.com
	**Toby Robinson, Partner** T: +44 (0)20 7295 3035 toby.robinson@traverssmith.com		**Caroline Edwards, Partner** T: +44 (0)20 7295 3322 caroline.edwards@traverssmith.com
	**Huw Jenkin, Partner** T: +44 (0)20 7295 3213 huw.jenkin@traverssmith.com		