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PUBLIC DISCLOSURE OF INSIDE INFORMATION

Inside information is the central concept of the notion of public disclosure of inside information as well as of insider dealing. This paper aims to determine whether the notion of inside information is the same within the two concepts and whether it should be. Two hypotheses have been analyzed firstly, the need to separate the unique concept of inside information, which has been accepted in Serbian and EU law, and secondly, the need to limit the issuer's broad discretion with regard to the issue of delaying public disclosure. Finally, the concept of delaying public disclosure of inside information in connection with problem of rumors and "leaked" information has been looked into in details.

Key words: *Disclosure. Inside information. Delaying disclosure.*

1. INTRODUCTION

Public disclosure of information is necessary to ensure that the public is adequately informed. Consequently, the disclosure of inside information is significant as a part of reporting to the public on inside information. Public disclosure should be carried out in such a way that information is made easily and promptly accessible, which is best achieved by placing on the Internet sites of the companies. It is interesting that the term "data" is used in spoken language to refer to the registration of data, while the term "information" is used concerning the disclosure. Data refers to a fact, while information can be knowledge of the fact and not the fact itself.¹ Therefore, on the basis of the above, the right term to use with

¹ See S. Bunčić "Privilegovane informacije u evropskom i srpskom pravu određenje pojma" ["The Notion of Insider Information in the European and Serbian law"], *Poslovna ekonomija [Business Economics]* 2/2008, 17.

regard to disclosure is “information”. Taking into account that it is reported to the public, i.e. to an unspecified number of persons for whom it is assumed that they are not in the possession of the inside information, a question may be posed as to whether such information is intended to the general public or to a particular group of persons. Amongst the persons to whom the information is certainly intended are investors. On one hand, these are potential investors, i.e. investors from the primary issue and secondary market buyers and on other are shareholders who have already decided to invest their capital, to whom the information is of multiple significance (e.g. to decide on sale of shares if information is adverse to the company). Lately, much has been written about the creditors as persons to whom the disclosure is addressed to.² All of them must be equally informed in order to be able to make economically rational decisions which will result in the establishment of appropriate share prices thus contributing to the market efficiency.³ The total symmetry of information and absolutely efficient market are just theoretical models, i.e. utopia. The task of a legislator is to try to find a solution that will enable the establishment and maintenance of markets that are as efficient as possible. That is the main goal of the notion of disclosure. It could be asserted that disclosure is a matter of public importance, as a process that involves a large number of persons leading to a decline in information asymmetry.⁴

Disclosure can be divided into the one relating to company law and another relating to the capital market law. In either case, the connection between these two approaches is unbreakable provided that investors become shareholders by purchasing securities of the issuer. The disclosure is an area where company law and capital market law overlap and are observed jointly, pursuant to the Report of the High Level Group of Company Law Experts for the reform of EU company law in 2002.⁵ It is also important to note that both legal and economic sciences are equally involved in the issue of disclosure. For this reason, there is empirical evi-

² See, for example, T. Jevremović Petrović, “Obavezno objavljivanje kao instrument zaštite poverilaca u kompanijskom pravu” [“Creditor Protection Through Mandatory Disclosure Rules”], *Pravo i privreda [Law and Economy]* 4 6/2011, 195–197.

³ See, for example, T.L. Hazen, “Identifying the Duty Prohibiting Outsider Trading on Material Non Public Information”, *Hastings Law Journal* 4/2010, 1–2, <http://ssrn.com/abstract=1472090>, last visited 20 August 2011; E. Čulinović Herc, “Povreda obaveze objave podataka na tržištu kapitala i sporovi ulagatelja (dioničara) protiv uvrštenih društava” [“Infringement of the Obligation to Disclose Information in the Capital Market and Disputes Between Investors (Shareholders) and Listed Companies”], *Zbornik Pravnog fakulteta Sveučilišta u Rijeci [Collected Papers of the Law Faculty University of Rijeka]* 1/2009, 148.

⁴ See C. Villiers, *Corporate Reporting and Company Law*, Cambridge 2006, 15, 30–32; J.L. Hansen, “The trinity of market regulation: Disclosure, inside trading and market manipulation”, *International Journal of Disclosure and Governance* 1/2003, 83.

⁵ Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002, 32.

dence of how disclosure affects the operations of the company, for example, how larger companies adopt more rigorous measures of disclosure, which in turn leads to the employment of more capable and better-paid management.⁶ There are also opinions that the purpose of public disclosure, as a form of disclosure, is not to protect investors nor shareholders (because, for example, investors are protected by diversification of risk) but to improve corporate governance instead due to the impact of disclosure on behavior of the management, as well as greater liquidity of capital markets, which leads to better allocation of resources.⁷ Furthermore, even the rules relating to disclosure in connection with corporate governance cannot be entirely subsumed under the rules of company law nor the capital market law.⁸

If the time of establishment of the company is used as the criterion, disclosure can be divided into preceding one which is a precondition for the foundation of the company, i.e. disclosure through the prospectus and the disclosure in the course of business operations of the company. The latter type of disclosure can be divided into periodic and *ad hoc* disclosure depending on the time when duty arises, at specified time points or when the disclosure time is unknown in advance. *Ad hoc* disclosure primarily relates to the duty to disclose inside information, to inform about the acquisition or loss of major holdings or major proportions of voting rights as well as to disclose in the case of takeover. Information about change of major holdings does not constitute inherently inside information concerning the issuer but market information instead since they relate only to the market (price change is likely to happen if number of shares is large), as evidenced by the special legal regulation thereof, while the takeover presents a concretization of the general rules of the Directive 2003/6/EC on insider dealing and market manipulation (market abuse) (hereinafter: the Market Abuse Directive).⁹

⁶ B.E. Hermalin, M.S. Weisbach, "Information Disclosure and Corporate Governance", Fisher College of Business Working Paper No. 2008-03-16, 1-3, <http://ssrn.com/abstract=1082513>, last visited 20 August 2011.

⁷ M. B. Fox, "Civil Liability and Mandatory Disclosure", *Columbia Law Review* 2/2009, 16-17, <http://ssrn.com/abstract=1115361>, last visited 20 August 2011; J.R. Brown, Jr., "Corporate Governance and Corporate Disclosure", Working Paper 09-10, 2B-5, <http://ssrn.com/abstract=1396353>, last visited 20 August 2011.

⁸ Thus, with regard to company law, information is disclosed at the assembly or in annual reports, while, with regard to the capital market law information is disclosed through the market and sometimes also on Internet site of the company, as is the case with disclosure in the company law. See K. Engsig Sørensen, "Disclosure in EU Corporate Governance – A Remedy in Need of Adjustment", *European Business Organization Law Review* 2/2009, 258-259.

⁹ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), *OJL* 96, 12/04/2003, 16-25; Regarding the character of the information on change of major holdings see Z.

The unique concept of inside information for the notion of public disclosure and insider dealing has been adopted in Serbian and EU law. It is necessary to define public disclosure of inside information in order to decide on whether it is advisable to separate the notion of inside information and limit the issuer's broad discretion with regard to the issue of delaying public disclosure.

2. DEFINITIONS

2.1. Definition of Public Disclosure

Public disclosure of inside information is a form of *ad hoc* disclosure, given the fact that it is not possible to determine in advance the time when the duty to disclose arises in the sense of its concretization. It could also be categorized as continuous disclosure, bearing in mind that the duty to disclose exists as long as the company itself.¹⁰ By its character, it belongs to mandatory disclosure, because of legal obligation of such disclosure in the fulfillment of prescribed conditions, as opposed to the vol-

Arsić, "Insider Trading", *Pravo i privreda [Law and Economy]* 1 2/1996, 45; Directive 2004/109/EC of the European Parliament and of the Council of December 15, 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, *OJ L* 390, 31/12/2004, 38 57, Article 9; See also S. Grundmann, F. Möslein, *European Company Law Organization, Finance and Capital Markets*, Antwerpen Oxford 2007, 432 437; Regarding disclosure in the case of takeover see Article 6 (1 2) and Article 8 of the Directive 2004/25/EC of the European Parliament and of the Council of April 21, 2004 on takeover bids, *OJ L* 142, 30/04/2004, 12 23, and S. Grundmann, F. Möslein, 604 606.

¹⁰ Disclosure from the Directive on Market Abuse some authors also call a continuous disclosure or ongoing duty to disclose. See J.L. Hansen, D. Moalem, "The MAD disclosure regime and the twofold notion of inside information: the available solution", *Capital Markets Law Journals* 3/2009, 323; C. Di Noia, M. Gargantini, "The Market Abuse Directive Disclosure Regime in Practice: Some Margins for Future Actions", *Rivista delle società* 4/2009, 6, <http://ssrn.com/abstract=1417477>, last visited 20 August 2011. A division can also be made into disclosure at the primary market, secondary market, i.e. periodic disclosure and *ad hoc* disclosure, see E. Člinović Herc, (2009), 135. In the law of the United States there is no identical duty because the issuer has the duty to disclose information periodically and to disclose information about certain events, which further means that the issuer from the US would have to disclose the information earlier than it would be the case under the law of the US, if its shares were quoted at regulated EU market. See E.F. Greene, "Resolving Regulatory Conflicts between the capital markets of the United States and EU", *Capital Market Law Journal* 1/2007, 25. See 8 K form of United States Securities and Exchange Commission, <http://www.sec.gov/about/forms/form8k.pdf>, last visited 20 August 2011. Duty to disclose arises in three cases: in case of disposing of own shares, when the omission is necessary to prevent the statement from misleading the public and when such a duty is determined by law or rule. See M. Cain, "Corporate Law Securities Fraud Impact of *In re Time Warner* on Corporate Information Management: Hying One Business Strategy May Give Rise to a Duty to Disclose an Alternate Strategy Under Rule 10b 5", *South Texas Law Review* 4/1994, 761.

untary disclosure that depends on the willingness of the issuer. There have been many theoretical debates as to whether disclosure should be mandatory or not. Although expensive for the issuer, it reduces the costs of investors in their search for information because of the fact that each investor has to find the information first in order to make sure that it is correct.¹¹ Afterwards, the analysis of the information itself is carried out and only then a decision is made whether to invest or not. Therefore, the disclosure is significant for competitors – to be aware of their own position in the market, for creditors, employees, suppliers and consumers – to improve their position in negotiations, also for investors – to evaluate whether they should purchase securities or not, and ultimately for the shareholders – to decide whether they still want to stay shareholders or they want to sell their shares and thus leave the company.¹² If the disclosure of inside information were voluntary, the decision to disclose would be adopted by the management of the company. Thus, depending on the type of inside information (e.g. if it was negative and showed the inability of management to lead the company properly or that members of the management would gain profit using the ignorance of another), management could often decide not to disclose inside information. It can be concluded that the disclosure of inside information has to be mandatory for the above-mentioned reasons.

A division can also be made on the basis of the manner of disclosure of inside information – written and oral. In regards to the manner of disclosure, posting of inside information on the Internet site of the issuer is compulsory and other means of disclosure can also be set forth.¹³ Making written disclosure mandatory is the only acceptable solution bearing in mind the nature of disclosure, i.e. the fact that it is reported to the public. In conclusion, disclosure of inside information presents *ad hoc* reporting to the public, which is mandatory during the issuer's business operations pursuant to the law.

2.2. Definition of Inside Information

In general, information has to arise at some point, and it is then inevitable that a small circle of people becomes aware of it.¹⁴ The information is necessary for all above-mentioned persons; thus, information through disclosure is a method of teaching these people.¹⁵ The term in-

¹¹ See Z. Goshen, G. Parchomovsky, "The Essential Role of Securities Regulation", *Duke Law Journal* 4/2006, 737.

¹² *Ibid.*, 756.

¹³ Market Abuse Directive, Article 6 (1) (2).

¹⁴ See E. Engle, "Insider Trading: Incoherent in Theory, Inefficient in Practice", *Oklahoma City University Law Review* 1/2008, 503.

¹⁵ Information (lat. *informatio*) is teaching, referencing, instruction, notice, notification, etc. See Milan Vujaklija, *Leksikon stranih reči i izraza* [*Lexicon of Foreign Words and Phrases*], Belgrade 1991, 353.

side information is a central concept of two different legal notions which, to a certain extent, have the same goal – notion of insider dealing and notion of public disclosure of inside information. Concerning that these are two different notions, the question is posed whether such information is defined in the same way with regard to both notions and whether it should be the case.

Duty to disclose inside information in Serbia is regulated by the Capital Market Act.¹⁶ Compared to the previous Act which regulated this field, the Securities and Other Financial Instruments Market Act, one of the novelties is that the new Act determines its objectives, namely: *protection of investors, ensuring fair, efficient and transparent market* and reduction of systemic risks in the capital market (Italic by the author).¹⁷ In the new Act, the term inside information is used instead of privileged information that was used in the old one. It is defined as information on precisely specified undisclosed facts that directly or indirectly relates to one or more issuers or to one or more financial instruments which would, if they were disclosed in public, probably have significant effect on the prices of those financial instruments or related derivative financial instruments.¹⁸ Thus, the information must meet four conditions to be considered as inside information. The first one is that it must not be disclosed; the second is that it refers to a precisely specified fact; the third is that this fact relates, directly or indirectly, to one or more issuers or one or more financial instruments; and lastly is that it has to be price sensitive, i.e. that the disclosure thereof would probably have significant effect on the prices of those financial instruments.¹⁹ The Capital Market Act also defines significant effect on the price that exists if a reasonable investor would probably take into account the inside information as part of the basis for making investment decisions, i.e. to buy or sell a financial instrument. In order for the fact to be considered precisely defined, two cumulative conditions have to be fulfilled: 1) that it is about a set of cir-

¹⁶ Capital Market Act (hereinafter in footnotes referred to as CMA), *Official Gazette of Republic of Serbia*, No. 31/11. Application of this Act is postponed for 6 months from the date of its entry into force.

¹⁷ CMA, Article 1 (2); Securities and Other Financial Instruments Market Act, *Official Gazette of Republic of Serbia*, No. 47/2006.

¹⁸ CMA, Articles 2 (46) and 75 (1). The same definition is also in Article 1 (1) of the Market Abuse Directive.

¹⁹ See M. Vasiljević, *Kompanijsko pravo [Company Law]*, Belgrade 2011, 408; J. Lepetić, “O pojmu *insider* a u pravu Sjedinjenih Američkih Država” [“About the Concept of Insider in the Law of the United States of America”], *Pravo i privreda [Law and Economy]* 4 6/2010, 161–162. On the concept of inside information see K.J. Hopt, “The European Insider Dealing Directive”, *Common Market Law Review* 27/1990, 57–61; S. Bunčić, 15–18. In the US law, disclosure of material information is mentioned, i.e. information that would be of significance to the investors due to the effect of such information on the price of securities, see D. C. Langevoort, M. G. Gulati, “The Muddled Duty to Disclose Under Rule 10b–5”, *Vanderbilt Law Review* 5/2004, 1644.

cumstances²⁰ or an event, i.e. more precisely, a *set of circumstances* that exists or *may be reasonably expected to come into existence*, or an event that has already occurred or *may be reasonably expected to occur* (Italic by the author); 2) the information is identifiable enough so that it can bring a conclusion on the possible effect thereof on the prices of financial instruments. Thus defined inside information satisfies the need for application of the notion of insider dealing. With regard to derivatives on commodities, inside information is separately defined as information on precisely specified undisclosed facts, which directly or indirectly relate to one or more such derivatives, which market users would expect to receive in accordance with established market practices in those markets. Notable difference from the general definition of inside information is the fact that not only is the effect on price not mentioned but also the concept of established market practice is introduced.²¹ Regarding the persons responsible for the implementation of client orders, inside information is also specifically defined, but the effect on price is mentioned in this case.²²

Concerning the notion of public disclosure of inside information from Article 79 of the new Capital Market Act, the situation is somewhat different. The difference in establishing the definition of inside information with regard to these two notions is contained in the fact that, in terms of the notion of disclosure, the inside information may relate only directly to the issuer in order for the mentioned duty to arise, which is not the case with inside information in terms of the notion of insider dealing.²³ The above restriction is reasonable because one cannot expect the issuer to disclose information that would affect the prices of its securities and that do not depend on the issuer nor come from it, such as financial crisis in the country where the company is registered or the Central Bank decision on interest rates.²⁴ On the other hand, if a company opened a new plant or appointed a new director or if a merger with other compa-

²⁰ Concerning a set of circumstances, inside information is a group of information, where each of them is not inside information itself. See C. Di Noia, M. Gargantini, 12 fn. 54.

²¹ CMA, Article 75 (3-6). The European Commission also recognizes non mentioning the effect on price of financial instruments as a problem. See Working document of the European Commission, Public Consultation on a Revision of the Market Abuse Directive MAD, 25 June 2010, 4, http://ec.europa.eu/internal_market/consultations/docs/2010/mad/consultation_paper.pdf, last visited 20 August 2011.

²² CMA, Article 75 (7).

²³ Also C. Di Noia, M. Gargantini, 8.

²⁴ As well as M. Siems, "The EU Market Abuse Directive: A Case Base Analysis", *Law and Financial Market Review* 2/2008, 12, <http://ssrn.com/abstract=1066603>, last visited 20 August 2011. There is also a division of information into untested, unsafe or soft information as, for example, projections, opinions, analyses, and statements on proven facts or hard information. See J.E. Kerr, "A Walk through the Circuits: The Duty to Disclose Soft Information", *Maryland Law Review* 4/1987, 1071.

nies would take place that would have a direct influence. This is the only difference provided by Serbian law, but is it sufficient?

2.3. Definition of Insider Dealing

It is necessary to briefly define insider dealing for greater clarity of this paper in general. It has already been stated that inside information is not only the central concept of the notion of public disclosure but also of insider dealing. Insider dealing is defined in Capital Market Act as a use of inside information by acquiring or disposing of financials instrument to which that information relates or trying to acquire or dispose of the same, directly or indirectly by insider for his/her own account or the account of a third person.²⁵ The time of the use of information is before the time of its disclosure. By abusing inside information, insiders try to make a profit or avoid a loss.²⁶ The purpose of banning the abuse of inside information is above all to ensure investors' confidence in financial markets.

3. THE PROBLEM OF ANTICIPATING FUTURE EVENTS

3.1. Formulation of the problem

Is it justified to require from an issuer to publicly disclose inside information which presents a set of circumstances which still does not exist but for which it may be reasonably expected that it will come into existence or an event which has still not occurred but may be reasonably expected to occur? According to the Capital Market Act, there is no difference between inside information for the needs of the notion of insider dealing and the one for needs of public disclosure. There is a possibility that this difference would be made in a by-law regarding the information to be taken into account in deciding upon disclosure, to be adopted by the Serbian Securities Commission. The said distinction should be made for many reasons. Public disclosure of uncertain and unverified information which has not come into effect, could lead to serious consequences and have little benefit. If the set of circumstances or the event does not come into existence, the following situations could occur: a company would have to disclose new information that would disprove the old one which would certainly cause costs for the company; numerous court cases could arise, in which the investors could claim they were misled, because their reached and implemented investment decisions were a consequence of

²⁵ CMA, Article 76.

²⁶ See N. Jovanović, *Berzansko pravo [Stock Exchange Law]*, Belgrade 2009, 413.

something that was officially announced but in fact did not happen; investors' confidence in a particular company could be quite destabilized, which in turn could lead to a decrease in prices of its shares; an issuer who does not know how to act might seek the opinion of the Securities Commission, which would additionally burden its work and would definitely lead to prolonged disclosure; issuers would use the possibility of delaying public disclosure more often in order to avoid possible costs and responsibility; disclosure itself could change the course of events. The only potential benefit from disclosure in this phase would be the early supply of information to all market participants which would prevent an insider from making a profit, as he/she would not be in the possession of inside information any longer. On the other hand, penalties for insider dealing, obligation to draw up lists of insiders and duty to notify the competent authority on the existence of transactions are sufficient instruments of protection in this regard. Therefore, the previous argument is not sufficient to deem disclosure of unverifiable information justified.

The disclosure of major new developments was regulated by the old Securities and Other Financial Instruments Market Act. The phrase "once a set of circumstances comes into existence" which was contained in Article 64 clearly indicates that the duty to disclose did not comprise future events. The answer to the question of how and why the situation has been changed by the Capital Market Act should be looked for in EU law. Public disclosure of inside information in EU law is regulated by the Market Abuse Directive which has adopted the unique concept of inside information for the notion of public disclosure and insider dealing.²⁷

²⁷ Distinction between the two notions has not been made in Article 6 (1) of the Market Abuse Directive, which regulates the duty to disclose inside information, nor in Article 79 (1) of the Serbian Capital Market Act. The unique concept of inside information for both insider dealing and public disclosure has been interpreted in different ways in EU member states, which resulted in many attempts to solve this problem in theory. See the Report of European Securities Markets Expert Group ESME, Market abuse EU legal framework and its implementation by Member States: a first evaluation, Brussels, 6 July 2007, 5, http://ec.europa.eu/internal_market/securities/docs/esme/mad_070706_en.pdf, last visited 20 August 2011. In the Report of European Securities Markets Expert Group from 2007 a suggestion was made that the definition of inside information with regard to the issue of public disclosure was clarified, or that certain amendments to the regulation of delaying public disclosure were made. EU sources of law regulating public disclosure of inside information consists of: Market Abuse Directive, Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, *OJ L* 339, 24.12.2003, 70-72, Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, *OJ L* 162, 30.04.2004, 70-75, Committee of European Securities Regulators (CESR), Market Abuse Directive, Level 3 – Second set of guidance and informa-

3.2. Distinguishing the notion of inside information

It seems logical that the prohibition of the abuse of inside information occurs before the obligation to publish the information. A possible scenario could be that a secretary of a company's management board director attended a part of the director's meeting with another company's director about a possible merger of the two companies. The secretary heard a sentence in which the director said that a merger with that company would be very desirable and that he/she would do his/her best to make it happen. The directors led an informal discussion and an agreement was made that they would be in touch. Bearing in mind that the secretary had worked for the director for a long time, based on her experience, she assumed that the job would be completed successfully. The whole set of these and other circumstances (e.g. it is a single-member company; the directors of companies negotiating are in family ties) makes the secretary, who is in hold of the inside information, a primary insider. From that moment, she must not abuse this information, but it could not be claimed that this is the moment when the duty to disclose information on a possible merger of the two companies arises under the Capital Market Act. The fact that the secretary would have to risk, to a certain extent, to make her investment decision cannot absolve her of the liability because she has an informational advantage over the other contracting party.²⁸ Duty to disclose for the company arises significantly later, i.e. after preparing a draft contract that the company is obliged to publish on its website and deliver to the register of economic entities not later than one month prior to the meeting of the Assembly in which the decision on the merger is brought under the new Company Act.²⁹ It could be argued that the duty to disclose does not arise until the start of implementation of work planning, negotiations, etc.³⁰ It is true that every disclosure prevents insider dealing because the inside information thus loses its inside character. Nevertheless, the purpose of prescribing the duty to disclose in the Market Abuse Directive in Article 6 (1) is not to prevent insider dealing only, because this is achieved by prescribing the prohibition of trade in

tion on the common operation of the Directive to the market, ref: CESR/06 562b, <http://www.esma.europa.eu/popup2.php?id 4683>, last visited 20 August 2011, Committee of European Securities Regulators (CESR), Market Abuse Directive, Level 3 Third set of guidance and information on the common operation of the Directive to the market, ref: CESR/09 219, <http://www.esma.europa.eu/popup2.php?id 5727>, last visited 20 August 2011.

²⁸ See also J.L. Hansen, D. Moalem, 331.

²⁹ See Company Act, *Official Gazette of the Republic of Serbia*, No. 36/11, Article 495. This Act shall apply as of 01 February 2012, except for Article 344 (9) and Article 586 (1) (8) that shall apply as of 01 January 2014.

³⁰ H. Krause, "The German Securities Trading Act (1994): A Ban on Insider trading and an Issuer's Affirmative Duty to Disclose Material Nonpublic Information", *International Lawyer (ABA)* 3/1996, 584.

financial instruments, referred to in Article 2 (1) and Article 4, and prohibition of selective disclosure from Article 3 of the Directive.³¹

The definition of inside information, i.e. the part relating to the precisely specified facts from Article 75 (5) of the Capital Market Act has been taken from Article 1 (1) of the Directive No. 124/2003. The obligation of Member States to ensure that issuers comply with their duty concerning disclosure with regard to a set of circumstances or an event that was not yet formalized is provided for in Article 2 (2) of that Directive which relates to the time of disclosure of inside information. Such disclosure must ensue promptly after the occurrence. This Article does not mention a set of circumstances that still does not exist but can be reasonably expected to exist or an event that did not occur but can be reasonably expected to occur as it the case in Article 1 (1) of the same Directive and in Article 75 (5) of Serbian Act. It can be concluded that the notion of inside information is different in relation to the concept of insider dealing and in relation to the disclosure of inside information because the notion is narrower in the latter where it refers only to an event or set of circumstances which has occurred although it has not been formalized.³² If there has already been a selective disclosure of inside information, duty to disclose a set of circumstances or an event that has still not occurred will arise. This is the case where the issuer or a person acting on its behalf reveals inside information to a third party in the normal course of the exercise of their employment, profession or duties, because then the issuer has a duty (unless the information was discovered to a person that has a duty to maintain confidentiality, for example, a physician regardless of the basis for this duty) to disclose such inside information as well as in the case when the governing authority orders so in the exercise of its powers in order to allow adequate public information.³³ There is another difference which is of minor importance at first sight but can be significant in practice. The Market Abuse Directive, in Article 6 (1), provides the duty for an issuer to disclose inside information “as soon as possible”, while Serbian law uses the phrase “without delay” in Article 79 (1) of the Capital Market Act. Furthermore, the Directive No. 174/2003, in the above-mentioned Article 2 (2), uses the term “promptly” which, according to some authors, is not accidental because the Market Abuse Directive mentions events that have not occurred, which is an additional argument

³¹ See J.L. Hansen, D. Moalem, 331; S. Grundmann, F. Möslin, 469-470. On the other hand, some authors consider it the best form of fight against insider dealing, for example, E. Čulinović Herc, (2009), 148, or prevention of insider dealing and means to achieve allocative efficiency of capital markets, for example, M. Siems, 12.

³² See J.L. Hansen, D. Moalem, 329.

³³ See Capital Market Act, Article 82 and Market Abuse Directive, Article 6 (3) (1-2) and Article 6 (7). See J.L. Hansen, D. Moalem, 338-339.

for the previous claim.³⁴ In any case, if there is a significant change in the already published inside information, for example, a contract is not signed after all, meaning that there was no formalization but the obligation of disclosure did occur and where there was no legitimate interest to delay disclosure, the issuer is obliged to disclose the new information immediately upon the occurrence of such change.³⁵ The issue of negotiations and the contract itself is a subject matter of contract law, and accordingly, this interpretation would create a need for special understanding of the contract, with a view to distinguish between the finalization of negotiations, i.e. a formal closure of a contract and the moment when it is already clear that the contract will be concluded, which would further mean that the closure of the contract would have a special meaning in the field of capital markets law, which would, at least, complicate the situation.³⁶

Theoretically, it could be argued that the time when the duty to disclose occurs precedes the time of realization of the duty to disclose thus the uniformity of the concept of inside information is not brought into question, that is, Article 2 (2) of Directive No. 124/2003 does not aim to define inside information itself for the needs of the notion of disclosure but rather only the time of disclosure of inside information.³⁷ It seems that this explanation has no practical significance because if it is claimed that inside information is uniformly defined and that it refers to an event or set of circumstances that has still not occurred, while an obligation of disclosure of inside information exists, then the whole notion of disclosure would in fact refer only to a part of inside information because some of the events to which the information refers would never be realized. It is true that it is all about the moment, not the subject of disclosure as the main problem. However, it is also a fact that this subject can also change in the meantime. If it were claimed that all inside information had to be disclosed, then unsafe information would also have to be disclosed as well as the changes that would occur subsequently as a form of its correction. In this case, the whole concept of disclosure would be an excep-

³⁴ See J.L. Hansen, D. Moalem, 329. More details on the problem of defining the terms immediately, as soon as possible or without delay are available in: T.M.J. Möllers, "The Immediateness of *Ad hoc* Disclosure Statements in the Context of National and European Legal Doctrine", *International Company and Commercial Law Review* 11/2007, 373 376.

³⁵ See Directive 124/2003, Article 2 (3).

³⁶ See J.L. Hansen, "A Stricter duty to Disclose Information to the Market in Denmark", *European Company Law* 2/2008, 48. In the Nordic legal systems the "reality principle" is known, according to which information should not be disclosed before it can be safely said that, for example, event to which this information applies will really occur. This principle was accepted in the Danish law thus a dispute arose whether it was contrary to the Market Abuse Directive and Implementing Directive 124/2003. *Ibid.*, 55.

³⁷ C. Di Noia, M. Gargantini, 12 13.

tion. In fact, regardless of possible theoretical setting, inside information is a different notion in terms of its usage for the two concepts. It can be concluded that all of the above information is inside, while some of it is suitable for disclosure and some is not. Although, in general, all inside information must be disclosed, if some of it is not realized in material terms, i.e. if it does not grow into an event, the disclosure will not occur. In any case, regardless of the accepted concept, it will have only theoretical significance.

Liability for failure to fulfill the duty to disclose or improper fulfillment in terms of contents and manner of disclosure is also in close connection with the duty to disclose non-verifiable, i.e. uncertain inside information. The issue of liability in case of disclosure of inside information that has changed is particularly important with regard to the problem of anticipating future events and the subsequent duty to disclose those changes.³⁸ Any tightening of liability, especially liability for disclosure of incorrect information (announcement that something will happen – and it does not happen, is an incorrect information for investor) could lead to reduction in the volume of voluntary disclosure thus to the lack of information and certainly to a delay in disclosure with a view to avoid sanctions and disputes.³⁹ In this respect, this is another argument for the need of splitting the notion of inside information.

4. DELAYING DISCLOSURE

4.1. Conditions

Under Serbian law, issuers are given the opportunity to delay the public disclosure of inside information on their own responsibility under three conditions: 1) if such disclosure would jeopardize their legitimate interests (closer circumstances which indicate the existence of a legitimate interest will be defined by the Commission in the new rulebook which is yet to be adopted);⁴⁰ 2) if the public would not be misled in this

³⁸ On responsibility with regard to disclosure in Serbian law see: N. Jovanović, “Izveštavanje o poslovanju akcionarskog društva” [“Reporting on Joint Stock Company’s Business”], *Korporativno upravljanje drugi deo* [*Corporate Governance Second Part*], (eds. M. Vasiljević, V. Radović), Belgrade 2009, 201. For comparative legal solutions see E. Čulinović Herc, (2009), 152–156.

³⁹ See U. Noack, D. Zetzsche, “Corporate Governance Reform in Germany: The Second Decade”, *European Business Law Review* 5/2005, 1050.

⁴⁰ At the moment, the Rulebook on Contents and Manner of Reporting of Public Companies and Reporting on Possession of Voting Shares, *Official Gazette of the Republic of Serbia*, No. 37/09, 100/06 and 116/06 and the Rulebook on the Sale of Securities to which Inside Information Relates, *Official Gazette of the Republic of Serbia*, No. 100/06 and 116/06 are still in force. Article 11 of the latter Rulebook provides for the obligation

manner and 3) if issuers can ensure confidentiality of that information.⁴¹ The Securities Commission has no authority to decide whether an issuer may delay disclosure but an issuer is obliged to inform the Commission of its decision to delay disclosure of inside information without delay. Under the old Securities and Other Financial Instruments Market Act, the Commission had more powers, i.e. it made decisions on termination of obligation of disclosure on important events at an issuer's request, which meant that the issuer could not make a decision to delay the disclosure itself.⁴² The existing legal solution in Serbian law is fully compliant with provisions from Article 6 (2) of the Market Abuse Directive. In EU law the answer to the question, what the legitimate interests for delaying the disclosure of inside information are, is given in Article 3 of the Directive No. 124/2003 where two examples are provided – one relating to negotiations and other concerning decisions or contracts concluded by the company's management which must be approved by another authority in the company.⁴³ Another question here is whether a situation in which it is upon the issuer itself to decide on whether to delay the disclosure presents sufficient protection. It is possible that there would be some changes in this respect, i.e. that there would be restrictions on such a broad discretion provided to the issuer.⁴⁴

Bearing in mind that the moment when the duty to disclose inside information arises has already been defined, it can be concluded that the possibility to delay the disclosure occurs only after the duty to disclose has arisen. The delay is possible only when there is an adequate level of safety, i.e. that an event or a set of circumstances has arisen but has still not been finalized. The closure of the contract through which the company would overcome the financial crisis would present an event which ought to be published before its finalization, i.e. before it is signed but not

of the issuer to submit a request to the Commission for exemption from the obligation to disclose any major new developments when there are legitimate reasons, meaning that disclosure would seriously endanger the company's business operations. Disclosure of major new developments is regulated by Article 64 of the old Securities and other Financial Instruments Market Act. On disclosure of major new developments see P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, London 2003, 591.

⁴¹ See Capital Market Act, Article 81.

⁴² Compare Capital Market Act, Article 81 (2) and old Act, Article 64 (5).

⁴³ The latter example is particularly significant in legal systems with two tier boards, due to the existence of managing and supervisory boards. See Edita Čulinović Herz, "Zlouporabe na tržištu vrijednosnih papira nova europska smjernica i Zakon o tržištu vrijednosnih papira" ["Abusive Transactions on Securities Market – New EU Directive on Market Abuse and Croatian Law on Securities Market"], *Zbornik Pravnog fakulteta Sveučilišta u Rijeci [Collected Papers of the Law Faculty University of Rijeka]* 2/2004, 766.

⁴⁴ See European Commission Working Document entitled: Public Consultation on a Revision of the Market Abuse Directive, 25.06.2010, 14.

during the negotiations or, for example, closure of a pre-contract, because it could undermine the closure of the contract, i.e. lead to withdrawal of the other contracting party thus threatening the survival of the company (in case of fulfillment of the requirements for initiating bankruptcy proceedings the delay cannot occur).⁴⁵ As for the condition relating to the issuer's ability to ensure confidentiality of information is concerned, its fulfillment is assessed in consideration of the following: whether the issuer controls the access to information, i.e. whether the issuer has taken effective measures to prevent the access to inside information to persons who do not need it for the exercise of their employment within the issuer; whether the issuer has taken measures to ensure that the person who has access to that information is made aware of his/her duties and possible sanctions; and whether the issuer is able to immediately disclose information if it fails to ensure its confidentiality.⁴⁶ Looking at the whole situation, it can be concluded that the disclosure of unsafe inside information will not occur in most cases. The question is whether it is justified to delay the disclosure of inside information if a large number of employees have that information, even though it is for the purpose of regular work performance. It is then questionable whether the issuer can ensure the confidentiality of information at all, since that many persons already have it. In fact, the permitted selective disclosure of information without real constraints occurs in this case, which in turn increases the possibility of insider dealing.⁴⁷ The idea of restricting the selective disclosure to employees or disabling delay of disclosure should be at least considered in this case.

4.2. The problem with rumors and relationship with "leaked" information

As previously noted, one of the conditions for the delay of disclosure of inside information to be allowed is that it would not mislead the public. The question is how to interpret this condition. For example, there were rumors that a company was performing a research with a view to introducing new technology in order to reduce production costs and to lower prices of final products thus gaining advantage over its competitors. The research proved successful on the basis of the first results but a large number of experiments were still needed to safely argue that it was not harmful, that the products were at least as good as before and so on. The information that the research had a positive outcome would certainly be the inside information. However, there would be no difference be-

⁴⁵ See Directive No. 124/2003, Article 3 (1).

⁴⁶ See Directive No. 124/2003, Article 3 (2).

⁴⁷ See more in C. Di Noia, M. Gargantini, 19 20.

tween the rumor and the inside information to investors, since they could not know whom the information originated from. For the purposes of this study, rumors as unverified information are being defined.⁴⁸ Their existence in the market is unavoidable.⁴⁹ The rumors may circulate for at least three reasons: firstly, because the information has “leaked”; secondly, because someone has guessed it right; and thirdly, because someone has deliberately let such rumors (for example, competitive company in order to provoke the subject issuer to comment because it performs similar research). Overall, rumors may arise from the within the company or outside of its sources.

It is necessary to divide unverified information into rumors not originating from the company and to “leaked” information relating to inside information that comes from the company, which is again not relevant from investor’s perspective because investors cannot know which one it is.⁵⁰ It is logical that the disclosure and the issuer’s comments refer only to “leaked” information, but how does the company itself know whether the information originated from its source or not? Therefore, the issuer must not delay the disclosure of information if it has “leaked”, because the issuer failed to ensure its confidentiality. In this way the situation with “leaked” information is adequately regulated.

The situation is different with rumors, i.e. unverified information, with a source outside the company. There is currently no duty to comment the rumors on the basis of above Directives regardless of whether they suit the actual situation, i.e. whether they are true or not. Despite the lack of duty, issuers are likely to voluntarily comment on false rumors if they adversely affect the price of its shares, but may choose not to do so if they are favorable to them. Arguments in favor of obliging the issuers to comment on false rumors given the fact that investors may be misled are: 1) investors do not distinguish between rumors and “leaked” information and 2) issuers have no interest to comment on false rumors that are favorable to them. According to CESR guidelines, the issuer, in principle, has no obligation to comment on rumors or speculations, including false rumors, which are, for example, published in a newspaper article or on the Internet but not by the issuer, unless the information is precise enough to indicate that it is a “leaked” information.⁵¹ Another problem is

⁴⁸ See J.L. Hansen, D. Moalem, 326.

⁴⁹ See K.J. Hopt, 59.

⁵⁰ See J.L. Hansen, D. Moalem, 326 327.

⁵¹ See the Second Set of CESR Guidelines from 2007, 4 5 and the Third Set of Guidelines from 2009, 14 15. In the case of *Electronic Specialty Co. v. International Controls Corp.*, the Court stated that the issuer is not required to give a statement to refute the claim of the magazine, while the U.S. Commission for Securities took a different stance regarding rumors in some cases. See D.J. Block, N.E. Barton, A.E. Garfield, “Af

to define the notion of enough precise information, therefore the solution used is the same as the one used for defining inside information.

If a rumor is false, it certainly misleads the public. One possible solution to the situation when there are false rumors in the market could be to prescribe the obligation for a company to make a statement and deny such rumors or at least to introduce the prohibition of delay of disclosure in this case. On the other hand, this would preset an additional cost and a burden to the company to monitor rumors. Moreover, the company would not have any interest in doing so, especially if the false rumor was positive for the company. The strongest argument against this solution is that there is adequate legal protection in the field of market manipulation.

If the rumors were correct, it would, regardless of their source, be unjustified to require the company to make a statement, because the abuse could be significant and the benefit would be small as in the example with a competitive company. On the other hand, the fact that rumor was correct would indicate that this was a “leaked” information as confidentiality was not ensured, and if it were incorrect then it should not be commented because the issuer was not a likely source.⁵² In any case, a rule that would clearly establish (non)existence of this obligation in a single way would be useful. If it were left to issuers to decide whether they would comment on rumors or not, they would act in line with their own interest, and would thus deny the information if it were negative for them or not so if the information were positive even though inaccurate.⁵³ If a denial statement were prescribed, or if the rumor were correct but imprecise and not from the company and if there were no possibility to delay the disclosure, it could be disastrous for the company (for example, in a financial crisis because that would impair the company’s ability to “pull out”). In a broader sense, an investor is misled as soon as the disclosure is delayed, especially if the information is negative, and the investor buys shares of the company during that time because the investor does not know that the disclosure is delayed.⁵⁴ Such an exception must exist, because it would not be possible to ensure normal business operations of companies, which is not in favor of shareholders or investors, as they would not have a reason to invest in that case. Having considered all the arguments, it seems that the best solution is to keep the practice of non-commenting.

firmative Duty to Disclose Material Information Concerning Issuer’s Financial Condition and Business Plans”, *Business Lawyer (ABA)* 4/1985, 1253.

⁵² This is how it is done in Great Britain and Spain. See C. Di Noia, M. Gargantini, 25-26.

⁵³ For division of inside information to positive and negative see J. Lepetić, 162-163.

⁵⁴ See C. Di Noia, M. Gargantini, 23.

5. CONCLUSION

Public disclosure of inside information, i.e. reporting to the public on inside information is necessary to all market participants in order to make economically rational investment decisions, which is a precondition for the existence of efficient market. Disclosure is a subject matter of study by both, company law and capital market law, which makes it very significant. The range of persons who could use such information is very wide as it includes shareholders, investors, competitors, creditors, employees, suppliers and consumers.

Public disclosure of inside information can be defined as a type of *ad hoc* reporting to the public which is required in the period of the issuer's business operations pursuant to the law, given the fact that it is not possible to determine in advance the time when the duty to disclose arises. On the other hand, this type of disclosure is categorized as continuous disclosure since the duty to disclose exists as long as the company itself.

Inside information is the central concept of the notion of public disclosure of inside information as well as of insider dealing. In EU law the unique concept of inside information has been adopted for both notions. Inside information is information on precisely specified undisclosed facts, which directly or indirectly relates to one or more issuers or to one or more financial instruments which would probably have significant effect on the prices of those financial instruments or on the prices of related derivative financial instruments, if they were disclosed to public. The problem arises due to the part of the definition concerning the unique definition of precisely specified facts that the information relates to, which is one of the conditions for the information to be considered as the inside one because it includes a set of circumstances that still does not exist, i.e. an event that has not occurred yet. Such a definition meets the needs for the notion of insider dealing but not for the notion of public disclosure of inside information due to the problem of anticipating future events. It is necessary to make that distinction because the anticipated set of circumstances need not necessarily occur, nor the event must come into existence, no matter how likely it seemed at the time when the duty to disclose arose due to several previously mentioned reasons. The grounds for the statement that the difference should also exist in relation to future events can be found in EU law, in the Directive 2003/124/EC implementing Market Abuse Directive. Given the fact that anticipation refers to the result of negotiations and that it is the crucial moment in the closure of a contract, a need to separate the definition of the concepts of negotiations and contracts would arise for the capital market law needs, which would further complicate the situation and disturb the cohesion of the legal system. The difference in establishing the definition of inside information with regard to these two notions is contained in the fact that inside infor-

mation may relate only directly to the issuer in order for the mentioned duty to arise in terms of the notion of disclosure, which is not the case with inside information in terms of the notion of insider dealing, in line with both Serbian law and EU law. For this reason, the concept of inside information is narrower in case of the notion of disclosure than in terms of the notion of insider dealing. It is true that, in the case of earlier disclosure, all the market participants would be provided with the same information which would prevent an insider from making a profit. However, the penalties for insider dealing, obligation to draw up lists of insiders and duty to notify the competent authority on the existence of transactions are sufficient protection instruments in this regard.

Another serious problem is the issue of liability of the issuer concerning the disclosure, bearing in mind that investors could be misled due to the significant change of the situation. In order to avoid penalty the issuer may delay disclosure, which would ultimately mean that the exception became the rule. The aforementioned is also contributed by the broad discretion of the issuer, which does not need permission to delay the disclosure. Accordingly, a limitation of this right should be at least considered.

The situation wherein there is reasonable duty to disclose a set of circumstances or events that have still not occurred exists in the case when selective disclosure of inside information has already occurred and when it is ordered by the competent authority in exercising of its competences in order to provide for adequate public information. If the information is received by a large number of people for the purpose of carrying out their duties, regardless of the duty of confidentiality, probability that the inside information will be used increases. Consequently, the need of restricting the allowed selective disclosure should be considered too.

Prohibition of delaying public disclosure in case of “leaked” information is an adequate response to that problem, since it can be considered as a form of penalty for the issuer who failed to ensure the sufficient confidentiality of inside information. A different situation is with rumours which are considered to be unconfirmed information whose source is outside the company. Practice of non-commenting is the most acceptable solution, especially given the existing protection in case of market manipulation, but it would be useful to provide for such rule in the secondary legislation in order to solve existing dilemmas.