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Recent Developments in Public Disclosure by Listed Companies

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SUMMARY

The robust demand for resources in Australia in recent years has resulted in a proliferation of new listed companies and renewed interest and growth in capital raising and exploration and development of resource opportunities by market participants. ASX and the Australian Securities & Investments Commission, the principal Australian capital markets regulators, have been active over the same period in implementation of new and enhanced rules, regulations and policies designed to ensure that our listed companies make continuous disclosure of information to the market.

This paper will examine the changes and developments in both the ASX Listing Rules and the Corporations Act with respect to regulation and enforcement of a continuous disclosure regime. Significantly, liabilities now attach to non-compliance, with provision now existing for statutory, civil and criminal penalties and sanctions applying in appropriate cases. The tools available to the regulators have expanded significantly and a review is provided of the range of enforcement options open to ASIC and others in the event of non-compliance.

ASIC has been active in the enforcement area and some recent cases involving enforcement proceedings and non-compliance will be examined. The scope of liability has broadened and attention will be given to an examination of the potential for liability (both civil and criminal) to be sheeted home to directors and advisers of listed companies for non-compliance. The renewed interest in exploration and mining both in and outside Australia and the availability of international capital has resulted in many Australian companies seeking foreign capital through foreign listings.

This paper will also briefly examine disclosure regimes in some of the more popular foreign markets where Australian companies have ventured in recent times. In light of the enhance liability regimes that now exist, some observations will also be made on availability of any potential defences, mitigating provisions and strategies, that may exist where there has been non compliance with disclosure

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obligations. This will include examination of appropriate corporate governance policies and systems that might minimise the risk of contravention of disclosure obligations.

INTRODUCTION

The obligation on companies and other entities in Australia in respect of continuous disclosure arises under:

- Listing Rule 3.1 of the Listing Rules of ASX;[1] and
- Section 674, *Corporations Act 2001* (Cth).[2]

Whilst the obligation in respect of continuous disclosure can extend beyond listed entities, the substantial focus of this paper will be upon listed entities being companies or other entities listed on ASX or other recognised stock exchanges.[3] The continuous disclosure provisions are intended to, inter alia, prevent select disclosure of market sensitive information.[4]

ASX LISTING RULES

Chapter 3 of the Listing Rules of ASX (Listing Rules) establishes the obligation on listed entities[5] to make continuous disclosure. The general disclosure obligations are found in LR 3.1,3.1A and 3.1B. The Listing Rules were re-cast and commenced on 1 January 2003 replacing a somewhat narrower rule. The new Listing Rules provide:

> "3.1 Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.
>
> 3.1A Listing Rule 3.1 does not apply to particular information while all of the following are satisfied:
>
> 3.1A.1 A reasonable person would not expect the information to be disclosed.
>
> 3.1A.2 The information is confidential and ASX has not formed the view that the information has ceased to be confidential.
>
> 3.1A.3 One or more of the following applies.

1 The obligation applies to Corporations and other entities listed on ASX.

2 This applies to all companies and entities which are "disclosing entities" within the meaning of that expression in s 9, *Corporations Act 2001* (Cth).

3 At the date of this paper, the Stock Exchanges operating in Australia are ASX Limited, National Stock Exchange Limited and The Bendigo Stock Exchange Limited.

4 *ASIC v Southcorp Ltd (No 2)* (2004) 48 ACSR 187 at 188 per Lindgren J.

5 Typically listed entities will be either companies or public trusts. For a definition of "entity" see Ch 19 of the Listing Rules.

- It would be a breach of a law to disclose the information;
- The information concerns an incomplete proposal or negotiation.
- The information comprises matters of supposition or its insufficiently definite to warrant disclosure.
- The information is generated for the internal management purposes of the entity.
- The information is a trade secret.

3.1B If ASX considers that there is or is likely to be a false market in an entity's securities and asks the entity to give it information to correct or prevent a false market, the entity must give ASX the information needed to correct or prevent the false market."

These rules create a wider general disclosure obligation. Importantly, the exception to disclosure is only available if all of the requirements set out in LR 3.1A are satisfied. Listing Rule 3.1B then enables ASX to deny the exemption from disclosure being required, if it forms the opinion under LR 3.1B that there is or is likely to be a false market which needs to be corrected by making the entity make appropriate disclosure.

Listing Rule 3.1

What is information?

There is no definition of what constitutes "information" for the purposes of the Listing Rules. Some guidance may be gleaned from the definition contained in s 1042A, *Corporations Act* (the insider trading provisions) which provides that for the purposes of those provisions information includes matters of supposition and matters relating to intentions. There does seem some support in the Listing Rules themselves for the term to be interpreted broadly rather than in a restrictive fashion.[6]

Reasonable person

The quality of information in question is to be assessed by a reasonable person and not from the point of view of a stockbroker, seasoned trader or in the case of a resource company, a geologist.[7]

Awareness

Under the definitions contained in the Listing Rules, a company becomes aware of information if a director or and executive officer has, or ought reasonably to have, come into possession of information in the course of his or her duties.[8] It does not extend to employees generally.

[6] See ASX Listing Rule 19.2.
[7] See *Riley v Jubilee* (2006) 59 ACSR 252 at 267 per Master Sanderson.
[8] See Ch 19 Listing Rules.

Materiality

It is not all information that will give rise to a disclosure obligation. The information must first be said to have a material effect. There is no definition of "materiality" in the Listing Rules. The accepted test appears to be that stated by the United States Supreme Court in the decision of *TSC Industries Inc v Northway Inc*[9] where the court stated: "There must be a substantial likelihood that the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available."[10]

That decision was adopted by the Western Australian Supreme Court in the recent decision of *Riley v Jubilee Mines NL*.[11] The *Jubilee* case highlights many of the problems within a corporate group with both the identification of material information and continuous disclosure.

In 1993 Jubilee held a tenement known as McFarlane's Find which was in two sections. WMC had a tenement running between the two sections. In August 1994 WMC wrote to the then geology manager of Jubilee advising they had inadvertently drilled on a portion of Jubilee's tenement. WMC provided a drill core log with the advice which showed anomalous nickel values at depth but no interpretation of the data was provided.

In September 1994 WMC wrote to Jubilee providing assay data for the five holes drilled. Whilst Jubilee's geology manager discussed this information with Jubilee's general manager, none of this information was brought to the attention of the Jubilee board at that time. The Jubilee employees felt that nothing further was to be done as due to the considerable expense that further interpretive and other work would entail which they also felt would be unjustified and of no benefit to Jubilee.

In May 1996 WMC met again with Jubilee and provided its interpretation of the 1994 drilling and cross sections of the results to Jubilee. This was the first time Jubilee had seen the cross sections. Subsequent to these discussions Jubilee made an announcement to the market that significant sulphide mineralisation had been located at McFarlane's Find.

The plaintiff in that case had held Jubilee shares and took the view in February 1995 that Jubilee's shares would be staying low and sold all of its shares. The plaintiff successfully sued basing a claim in both negligence and based on a breach of a precursor to s 674.[12]

The *Jubilee* case highlights the evidentiary difficulties in demonstrating that certain information will have the required quality. In that case Master Sanderson heard a variety of experts on both sides as to the nature of the information with respect to the drill results and whether that information, if generally available,

[9] 426 US 438 (1976).
[10] Ibid at 449.
[11] See (2006) 59 ACSR 252 at 312 per Master Sanderson.
[12] Section 1001A, *Corporations Act.*

would have had a material effect on the price of Jubilee shares and ultimately preferred the plaintiff's expert evidence over the defendant's.

ASX in their own Guidance Note 8 suggest the test for "materiality" is that in s 677, *Corporations Act* because of the similarity between the language in LR 3.1 and s 674. Section 677 provides relevantly that:

> "For the purposes of sections 674 and 675, a reasonable person would be taken to expect information to have a material effect on the price or value of ED securities[13] of a disclosing entity if the information would, or would be likely to influence persons who commonly invest in securities in deciding whether to acquire or dispose of the ED securities."

One obvious practical issue highlighted by this test is that in the mining and exploration context, information in the hands of more than on entity, may be viewed quite differently depending upon the identity and circumstances of the individual company. For example, promising drilling results from a joint venture may have quite a different "quality" as to materiality in the hands of a small fledgling explorer with a modest market capitalisation than say in the hands of a major mining company with a very substantial market capitalisation.

In a similar vein, drilling results achieved during exploration by a company in its infancy, may have a quite different quality than those obtained after mining has begun and additional resources are being sought. In *Flavel v Roget*[14] O'Louhglin J stated:

> "What one company should advise the Stock Exchange might not have to be advised by a second company; what should be advised by a company at one stage of its career might not have to be advised at another stage o fits career because of changed circumstances."[15]

It should be noted that disclosure under LR 3.1 is required whether the "information" is generally available or not.[16]

The use of examples

Under notes to LR 3.1, ASX has endeavoured to provide guidance to listed entities in respect of compliance. Some 17 examples are provided of information which would require disclosure if material under LR 3.1.

In the resources industry context, examples of note are:

- A change in the entities financial forecast or expectation
- Under-subscriptions or over-subscriptions to an issue
- A copy of a document containing market sensitive information that the entity lodges with an overseas stock exchange or other regulator which is available to the public

[13] "ED securities" are defined in s 111AD, *Corporations Act*.
[14] (1990) ACLC 237.
[15] Ibid at 243-244.
[16] This is in contrast to s 674, *Corporations Act.*

- An agreement or option to acquire an interest in a mining tenement, including the number of tenements, a summary of previous exploration activity and expenditure, where the tenements are situated, the identity of the vendor, and the consideration for the tenements
- Giving or receiving a notice of intention to make a takeover
- An agreement between the entity (or a related party or subsidiary) and a director (or a related party of the director).

Listing Rule 3.1A

The obligation for a listed entity to make continuous disclosure is not absolute with LR 3.1A containing a number of circumstances, the occurrence of which may preclude a listed entity from having to make continuous disclosure. These provisions are often expressed to be "carve-outs" in respect of the obligation to disclose. Some brief observations may be made.

It is not sufficient if, for example, a reasonable person would not expect disclosure of the information because of the potential likelihood of prejudice to the company. The other elements in LR3.1A.2 and 3.1A.3 need to be shown to exist before disclosure is not required. Many modern commercial agreements will contain a confidentiality provision binding on the parties. Typical examples in the resource context will be joint venture and farm-in agreements. Such provisions do not justify non-disclosure if LR3.1 requires disclosure to be made.[17]

The carve-out provisions are not without difficulty in operation. A case in point is the recent payment by Promina Group Ltd of a $100,000 fine after receipt of an infringement notice from ASIC alleging Promina had breached continuous disclosure obligations when it became aware of Suncorp-Metway's take-over proposal to acquire all of its shares. In that matter, whilst the proposal had been received and was confidential and incomplete negotiations were continuing, following the publication of a Dow Jones Newswire article reporting the proposal, ASIC considered that Promina should have informed ASX when the proposal ceased to be confidential as a result of this release.[18]

The decision highlights the difficulties confronting a company and its directors in such circumstances when, of course, the premature release of such information may work against the best interests of shareholders. It should also be noted that the reliance upon the so called "carve-outs" does not guarantee that liability may not be sheeted home to the company or its directors in other ways.

[17] See *Cultus Petroleum NL v OMV Australia Pty Ltd* (1999) 32 ACSR I, a case in the context of disclosure obligations under takeover law but equally applicable to the disclosure obligation under LR 3.1 where Santow J said that where there is a conflict between a statutory provision requiring disclosure of information in a takeover document and private equitable duty of confidentiality, the statutory provision must prevail (at p 20).

[18] See ASIC Media Release 07/06 issued 20 March 2007.

A case in point highlighting the difficulties facing directors in dealing with disclosure is *GPG (Australia) Trading v GIO Australia*[19]. In that case GPG acquired shares in GIO over several days in 1999 outlaying substantial money to acquire the same. Throughout May-August 1999 GIO made a series of market announcements concerning re-insurance losses.

It did transpire that during the course of that acquisition, GIO received various actuarial reports revising the estimate for losses from its re-insurance business which were expressed to be "preliminary" by the authors. However, no announcement was made to the market until a subsequent date. When the announcement was made, GPG stopped acquiring shares and a modified scheme of arrangement between GPG and GIO was approved. GPG crystallised a loss of $8.3 million and sought to recover this loss from GIO and AMP due to misleading and deceptive conduct in the announcements.

The conduct was found to be misleading and deceptive and highlights the difficulties that arise when matters might be still under consideration and further reports being sought. It would seem that the GIO board may have relied upon the carve-outs in LR3.1A.3 to withhold disclosure, as permitted under that Rule. Whilst the "carve-out" may have operated under LR3.1A to avoid disclosure, it did not prevent liability for non-disclosure arising under different statutory provisions.

Listing Rule 3.1B

This rule is likely to be involved when there are media rumours or speculation. Typically, when a company's share price rises quickly, ASX acts by inquiring of the company whether there is any explanation for the rise and whether there is any information known to the company which is not available to the market. This request (often colloquially called a speeding fine) is often a precursor to ASX invoking LR3.1B.

Guidance Note 8

ASX has published Guidance Note 8.[20] It contains ASX's views in respect of continuous disclosure. ASX has also seen fit to provide a number of practical working examples for guidance as to when disclosure is or is not required.

Companies ought to be mindful of the guidance afforded by these examples and, where in doubt, it is suggested a listed entity should err on the side of full and early disclosure. Despite the possible commercial prejudice that in a given case might attach to premature disclosure, the liability issues attendant upon breach of the continuous disclosure obligations are such, that it is difficult to be cavalier in approach here.

[19] (2002) 20 ACLC 178.
[20] Issued March 2002 and re-issued in January 2003.

SECTION 674, CORPORATIONS ACT

The Provisions

The *Corporations Act 2001* imposes strict continuous reporting obligations on disclosing entities. The current provisions were introduced into the *Corporations Act* in March 2002 as Ch 6 CA, replacing provisions that had been introduced in 1994.[21]

A central feature of the new provisions is that unlike their predecessors, the obligation is one of strict liability and there is no requirement as to intentionality, recklessness or negligence.[22] The purpose of the provisions was succinctly stated by the High Court in *Sons of Gwalia Ltd (subject to deed of company arrangement) v Margaretic*[23] in the following terms:

> "The obligation of continuous disclosure, introduced by the Act was specifically designed and enacted to protect shareholders and potential shareholders from losses that might be suffered from undisclosed facts and to afford a foundation that would prevent, compensate for and reduce the incidence of such losses."[24]

Section 674(1) provides relevantly:

> "**Obligation to disclose in accordance with listing rules**. Subsection (2) applies to a listed disclosing entity if provisions of the listing rules of a listing market in relation to that entity require the entity to notify the market operator of information about specified events or matters as they arise for the purpose of the operator making that information available to participants in the market."

Complementing this, s 674(2) states that:

> "If:
> (a) This subjection applies to a listed disclosing entity; and
> (b) the entity has information that those provisions require the entity to notify to the market operator; and
> (c) that information:
> (i) is not generally available; and
> (ii) is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities[25] of the entity;
> the entity must notify the market operator of that information in accordance with those provisions."

Failure to comply with this Act is a criminal offence as well as giving rise to a civil penalty provision.[26]

[21] The former provisions dealing with continuous disclosure were ss 1001A,1001B,1001C and 1001D.
[22] *ASIC v Southcorp (No 2)* (2004) 48 ACSR 187 at 189.
[23] (2007) 232 ALR 232.
[24] Per Kirby J at 262.
[25] "ED Securities" are defined in s 9, *Corporations Act.*
[26] See ss 1311(1) and 1317E.

The Elements

Essentially, s 674(2) imposes an obligation on the listed company or responsible entity of a listed scheme to notify the ASX of information required to be disclosed under LR 3.1 where that information:

- is not generally available; and
- is information that a reasonable person would expect, if it were generally available, to have a material effect on the price and value of the listed securities interests of the entity.

The major difference between s 674(2) and LR 3.1 is that LR 3.1 does not require that the information not be generally available in order to require disclosure to be made; it need only have the requisite "price sensitive" quality. "Information" is generally available if:

(a) it consists of readily observable matter; or
(b) both of the following apply:
    (i) it has been made known in a manner that would, be likely to, bring it to the attention of persons who commonly invest in securities of a kind whose price and value might be affected by the information, and
    (ii) since it was made known, a reasonable period for it to be disseminated among such persons has elapsed.[27]

Information that consists of deductions, conclusions or inferences drawn from either or both of the two paragraphs above is also information that is "generally available".[28] The terminology used raises issues as to:

- what category or class of person are required for it may be said that information is or is not readily observable; and
- what period of time might need to pass before it could be said that a reasonable period had been allowed.

In the Federal Court case of *R v Firns,*[29] differing views were identified as to what constitutes "readily observable matter". The majority considered that information may be "readily observable" even if no-one observed it at all.[30]

On the issue of what constitutes a "reasonable period" of time for the dissemination of information, in the United States case of *SEC v Texas Gulf Sulphur Co*[31] it was stated that merely announcing information was insufficient and that a reasonable period of time was required to allow the bulk of market participants to absorb the information.

[27] See s 676(2).
[28] See s 676(3).
[29] (2001) 19 ACLC 1495.
[30] Ibid at 1507.
[31] 401 F2d 833.

Materiality

Section 677 provides that a reasonable person is taken to expect information to have a material effect on the price or value of securities if the information would, or be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the securities.

NON-COMPLIANCE AND THE CONSEQUENCES OF CONTRAVENTION

Listing Rules

In the case of contravention of LR 3.1, it is open to ASX to take action in respect of enforcing of its Listing Rules. This includes suspension or de-listing. Additionally, it is open to ASX to take enforcement action in respect of the Listing Rules under the concluding compliance orders under s 793C, *Corporations Act*. Action may be taken by ASIC, ASX or any person aggrieved by non-compliance, such as a shareholder of the entity. A court can make orders in respect of the breach of Listing Rules under s 1101B(1)(a)(iii). These orders would include making of an injunction and the giving of directions to comply with the Listing Rules.[32]

Corporations Act

Offence

An entity that fails to comply with s 674(2) is guilty of an offence carrying a maximum penalty of 1,000 penalty units.[33]

Statutory penalty

The court may seek declaration orders that a person has contravened s 674(2) which may lead to a pecuniary penalty order and/or a compensation order. Contravention of s 674(2) entitles a court to make a declaration of contravention. In such a case, the court may order the contravening entity to pay a pecuniary penalty of up to $200,000 for an individual and $1 million for a body corporate.[34]

The first case on the new provision and enforcement proceedings including payment of a pecuniary penalty, was the case of *ASIC v Southcorp Ltd (No 2)*.[35] In that case there had been selective information given by an Executive General Manager by email of details as to the likely sales of premium wines in the 2003 financial year and the anticipated gross profit impact of the poor 2000 vintage on the 2003 results to certain analysts.

[32] See s 1101B(4).
[33] See s 1311(1), 1312 and Sched 3, *Corporations Act.*
[34] See s 1317G(1A).
[35] (2004) 48 ACSR 187.

Southcorp admitted the contravention of s 674(2) and reached agreement with ASIC that on any hearing as to contravention the appropriate penalty was $100,000.00. The Federal Court hearing dealt with the adequacy of the penalty. The case contains useful guidance as to the factors a court will take into account in assessing a civil penalty. They include:

- the general deterrent effect of the provisions;
- significant fall in the market value of Southcorp securities immediately after disclosure;
- absence of dishonesty or other impropriety;
- institution of a new disclosure regime by the company;
- admission of the contravention;
- involvement of only one officer at Southcorp;
- immediacy of action by Southcorp;
- unlikelihood of further contravention.

Most recently the enforcement provisions were examined in *ASIC re Chemeq Ltd.*[36] This was a case where ASIC had issued an infringement notice. Chemeq owned intellectual property associated with an anti-microbial product which could be developed as an alternative to antibiotics used to treat infection in livestock. In 2002 Chemeq notified the market that it was constructing a manufacturing plant in Western Australia. In 2003 announcements by Chemeq advised the anticipated construction cost was $A25 million. By the end of 2003 the board was aware anticipated construction costs had materially increased. ASIC alleged Chemeq had failed to inform ASX of the increase in the anticipated construction cost.

Additionally at the end of 2003 Chemeq informed the market that it had received approval for a US Patent for antimicrobials. This was followed by an announcement in 2004 that the grant of the US patent meant that Chemeq kept competitors from manufacturing or marketing polymeric anti-microbials in the US market. ASIC contended that Chemeq management knew at the time of the release that the patent was not material to Chemeq's commercial position because it protected only a particular method of formulating the product, not the product itself.

In that case, Chemeq Ltd admitted to the contraventions of the continuous disclosure provisions being:

- a failure to inform the market of cost over-runs in the construction of manufacturing facilities; and
- a failure to inform the market that certain patents that had been obtained in the US relating to a process for formulating a certain product, had no commercial significance.

[36] (2006) 24 ACLC 806.

The case provided further useful guidance to the factors that a court will take into account when imposing penalties for contravention. The Federal Court identified the following factors as relevant to the level of the penalty to be imposed for contravention of the continuous disclosure provisions:

- the extent to which the information not disclosed would have been expected to (and if applicable) did affect the price of the contravening company's shares;
- the extent to which the information, if not generally available, would have been discoverable upon enquiry by a third party;
- the extent (of any) to which acquirers or disposers of the company's shares were materially prejudiced by the non-disclosure;
- the extent to which (if at all), the contravention was the result of deliberate or reckless conduct by the corporation;
- the extent to which the contravention was the result of negligent conduct by the corporation;
- the period of time over which the contravention occurred;
- the existence, within the corporation, of compliant systems in relation to its disclosure obligations, including provisions for and evidence of education and internal enforcement of such systems;
- remedial and disciplinary steps taken after the contravention and directed to putting in place a compliance system or improving existing systems and disciplining officers responsible for the contravention;
- the seniority of officers responsible for the non-disclosure and whether they included directors of the company;
- whether the directors of the corporation were aware of the facts which ought to have been disclosed and, if not, what processes were in place at the time, or put in place after the contravention, to ensure their awareness of such facts in the future;
- any change in the composition of the board or senior manager since the contravention;
- the degree of the corporations co-operation with the regulator including any admission of contravention; and
- the prevalence of the particular class of non-disclosure in the wider corporate community.

Another ongoing high profile case involving enforcement action by ASIC pursuant to the civil penalty regime is the proceeding instituted by ASIC against Fortescue Metals Group Ltd and its CEO, Andrew Forrest. ASIC allege, amongst other things, that Fortescue contravened the continuous disclosure provisions when it made announcements on 23 August 2004 and 5 November 2004. In those announcements Fortescue claimed to have entered into binding contracts with

various Chinese companies to build and finance a railway, ship loading facility and related facilities.

ASIC allege Fortescue failed to disclose important information namely, that in fact concluded agreements had not been reached. ASIC have joined Mr Forrest in the proceedings contending he was knowingly concerned in the contraventions. The proceedings are ongoing and if they proceed to trial will provide further guidance on the operation of the continuous disclosure obligation provisions in Australia.[37]

Compensation

Contravention of s 674(2) would also entitle a court in an appropriate case to make an order that the entity compensate the person or managed investment scheme that has suffered damage.[38]

A current example of these provisions is the *Multiplex* case. The ongoing Federal Court proceedings involving a class action seeking damages arising from the alleged breach of s 674 and the Listing Rules.[39] That case arises out of the building of the new Wembley Stadium in London which was not completed within time and where the final cost of construction well exceeded the budgeted cost. In that case it is contended that Multiplex knew, or reasonably would have known that it was likely that construction was well behind schedule and that information about the project and its affect on profits was material information which contrary to the Listing Rules had not been disclosed.

Whilst Multiplex has reached agreement with ASIC and provided an enforceable undertaking and a compensation fund, that settlement does not affect the class action which continues.

The recent High Court case of *Sons of Gwalia v Margaretic* has broadened the rights of persons who hold shares in a listed company at a time when the company contravenes the non disclosure provisions.[40] That case concerned the status of the claims of an aggrieved purchaser of shares in Sons of Gwalia which went into administration.

The respondent claimed a right to damages against the company for losses caused by alleged breaches of, inter alia, LR3.1 and s 674(2), *Corporations Act* on the basis that the appellant had failed to notify ASX that its gold reserves were insufficient to meet its gold delivery contracts and that it could not continue as a

[37] See also the civil penalty proceedings ASIC has commenced in relation to James Hardie Industries Ltd, which includes proceedings against a number of former and current directors and former executives. ASIC Media Release 07-35 15 February 2007. ASIC contend that, inter alia, there were breaches of the continuous disclosure provisions in respect of the adequacy of funding of the compensation foundation set up to deal with asbestos claims.

[38] See s 1317HA.

[39] See *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1044.

[40] (2007) 232 ALR 232.

going concern. The administrator sought to rely upon s 563A, *Corporations Act*[41] and contended that the respondent was not entitled to prove with other creditors in any winding up of the company as any claim arose in the capacity of the respondent being a member and not as a creditor. As such, any claim to damages, if proved, would result in postponement of that claim in the winding up of the company behind the claims of all other creditors.

The High Court, by majority, rejected that argument. The Chief Justice commented that:

> "What determines the present case is that the claim made by the respondent is not founded upon any rights he obtained or any obligations he incurred by virtue of his membership of the first appellant. He does not seek to recover any paid-up capital, or to avoid any liability to make a contribution to the company's capital. His claim would be no different if he had ceased to be a member at the time it was made, or if his name had never been entered on the register of members. The respondent's membership of the company was not definitive of the capacity in which he made his claim. The obligations he sought to enforce arose, by virtue of the first appellant's conduct, under one or more of the statutes mentioned in the earlier description of the respondent's claim."[42]

This decision would appear to place all aggrieved shareholders who suffer loss as a consequence of non disclosure by a listed company, with the same ranking as all other general unsecured creditors in the event of insolvency of the company.

Infringement notices

Changes introduced by CLERP 9 in July 2004 have provided ASIC with power to issue infringement notices to listed entities that it reasonably believes have contravened the continuous disclosure provisions.[43] A new Pt 9.4AA was introduced.

The wide ranging provisions appear to be to enable ASIC to pursue and use its civil penalty power in cases of non-disclosure which were considered "relatively minor" and "less serious" rather than pursue them through the courts.[44] The provisions enable ASIC to allege contravention of s 674(2) by issuing an infringement notice as an alternative to taking civil penalty proceedings.

There is no review mechanism to the issue of an infringement notice. This has led to some criticism of these provisions on the basis that ASIC is both prosecutor

[41] Section 563A provides relevantly: "Payment of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied."

[42] (2007) 232 ALR 232 at 244 per Gleeson CJ.

[43] See s 1317DAC(1).

[44] See CLERP 9, Explanatory Memorandum, paras 5.457 and 5.458.

[45] See Welsh, "Enforcing contraventions of the continuous disclosure provisions: Civil or administrative penalties" (2007) 25 C&SLJ 315.

and judge.[45] These provisions have been used on a number of occasions by ASIC in lieu of seeking declarations as to contravention through legal proceedings. Infringement notices were issued in *Re Chemeq*.[46] A further five such notices have been issued by ASIC.[47]

The Act provides for a three tiered penalty system involving fines depending upon the market capitalisation of the listed entity.[48] From a practical viewpoint, payment of a penalty claimed in an infringement notice does not amount to an admission or finding of contravention and is not the equivalent of a conviction.[49] Whilst this gives certain immunity to a disclosing entity with respect to contravention of s 674(2), it should be noted that it does not prevent liability under other provisions of the *Corporations Act* or under the general law. This would extend to a claim based on misleading and deceptive conduct under s 1041H or equivalent provisions under the Fair Trading legislation. Hence the attraction of quickly and efficiently dealing with an "alleged" contravention by a company must be balanced against the fact that it may not be the end of the matter as far as the company or directors are concerned.

It should also be noted that payment of any penalty claimed under an infringement notice, does not exonerate any person proven to be involved with a contravention. This would extend to the listed entities directors.

Other liability issues

Non-disclosure may also give rise to other forms of liability such as those under ss 1041B, 1041E and s 1309.

Criminal

A company which breaches s 674(2) is liable to a corporate penalty under s 1312. Because of the nature of the offence, the *Criminal Code 1995* (Cth) will apply. Under the *Criminal Code*, the necessary fault element of contravention of s 674(2) can be attributed to the company if the company expressly, tacitly or impliedly authorised or permitted the commission of the offence.[50]

It is notable that the means by which this authorisation or permission may be established includes:

- proving that the body corporate's board of directors intentionally, knowingly or recklessly carried out the relevant conduct, or expressly, tacitly or impliedly authorised or permitted the commission of the offence; or

[46] See (2006) FCA 936.
[47] See Welsh, op cit n 45 at 329.
[48] The penalties are:
- $100,000 for a Tier 1 company (market cap in excess of $1,000m)
- $66,000 for a Tier 2 company (market cap from $100m to $1,000m)
- $33,000 for a Tier 3 company (market cap not more than $100m).

[49] Section 1317DAF(4).
[50] See s 12.3(1), *Criminal Code.*

- proving that a high managerial agent[51] of the body corporate intentionally, knowingly or recklessly engaged in the relevant conduct, or expressly, tacitly or impliedly authorised or permitted the commission of the offence; or
- proving that a corporate culture exists within the body corporate that directed, encouraged, tolerated or led to non-compliance with the relevant provision[52]; or
- proving that the body corporate failed to create and maintain a corporate culture that required compliance with the relevant provision.[53]

These provisions are wide ranging in nature and present obvious concerns for companies that may have lower levels of corporate governance standards than, for example, those issued by the ASX Corporate Governance Council.[54]

Enforceable undertakings

ASIC is empowered under the *Corporations Act* to accept enforceable undertakings from a listed entity to secure compliance in connection with any matter that is within ASIC's power.[55] A recent example where ASIC has accepted an enforceable undertaking is in the Multiplex Group case following a failure by that group to meet its continuous disclosure obligations arising out of the development of the Wembley National Football Stadium Project in London.

Shareholders who avail themselves of the compensation fund provided by Multiplex Group pursuant to this undertaking, will waive any rights to participate in a class action which has been instituted against Multiplex for losses suffered as a result of the company's non-disclosure.

Civil action

Liability may also arise based on misleading statements and omissions and negligence. *Riley v Jubilee Mines NL*[56] is an example of a successful civil law claim based on negligent failure by Jubilee to notify ASX of certain material information under the precursor to LR3.1.[57]

[51] A "high managerial agent" means an employee, agent or officer of the body corporate with duties of such responsibility that his or her conduct may fairly be assumed to represent the body corporate's policy: s 12.3(6).
[52] See s 12.3(2)(c).
[53] See s 12.3(2)(d).
[54] See Corporate Governance Principles and Recommendations issued 1 August 2002 and revised in 2007
[55] See s 93AA, ASIC Act.
[56] (2006) 59 ACSR 252.
[57] The claim arose under former s 1001A(2) and s 1005, *Corporations Act*. The latter provision provided damages for a person who suffered financial loss from a contravention of Pt 7.11.

Defences

Both criminal and civil consequences can flow from contravention of s 674. There are no defences available for criminal prosecutions. However, a court may excuse civil contraventions in certain circumstances.

Under s 1317S, relief can, in an appropriate case, be sought from contravention of this provision where the person can show:

- that the person has acted honestly;
- having regard to all of the circumstances of the case, the person ought fairly to be excused for the contravention.[58]

LIABILITY OF DIRECTORS AND OTHERS INVOLVED IN NON-COMPLIANCE

Section 79

Under s 674(2A), it is provided that a person who is *involved* in a listed disclosing entity's contravention, also contravenes that section.

Under s 79 of the *Corporations Act*, a person is taken to be "involved" in contravention, if and only if, the person has:

(a) aided, abetted, counselled or procured the contravention; or
(b) has induced, whether by threats or promises or otherwise, the contravention; or
(c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in or party to, the contravention; or
(d) has conspired with others to affect the contravention.

These provisions potentially allow civil penalty orders to be sought against directors, senior officers and possibly employees of listed entities.

The better view seems to be that a person is said to be "involved" in the relevant sense, if they have knowledge of the essential matters which make up the contravention, whether or not the person knows those matters were in law or contravention.[59]

The issue of advisers such as lawyers who advise on disclosure obligations is yet to be tested but some commentators consider that if an adviser incorrectly advises that no disclosure in a given situation is required and is wrong, then that adviser may meet the necessary test for accessorial liability as there is knowledge of the essential elements of contravention.[60]

[58] See s 1317S(2).
[59] See McConvill, "Introducing personal liability under the continuous disclosure regime: The 'essentials' and 'non-essentials'" (2004) 16 *Australian Journal of Corporate Law* 1 at 8 and 9 and *Yorke v Lucas* (1985) 158 CLR 661.
[60] Ford, *Principles of Corporations Law*, Ch 10, para 10.323.

Criminal Code

An individual involved in the contravention of the continuous disclosure provisions could also be subject to criminal liability as an accessory under s 11.2 of the *Criminal Code* (Cth). The section provides relevantly:

> "**Complicity and common purpose**
> 11.2 (1) A person who aids, abets, counsels or procures the commission of an offence by another person is taken to have committed that offence and is punishable accordingly."

In such cases, a person who received a penalty up to $22,000 or imprisonment for five years or both.

To be liable under the *Criminal Code*, a person must have aided, abetted, counselled or procured the commission of the offence by another person, who must have intended (or at least have been reckless to the fact) that the conduct would have this effect.

Professional advisers such as lawyers and corporate advisers will need to be cognisant of these provisions when advising on continuous disclosure obligations.

COMPLIANCE SYSTEMS AND DUE DILIGENCE

Section 674(2B) – Due Diligence Provisions

Section 674(2B) provides that a person does not contravene s 674(2A) if the person can prove that:

(a) they took all steps (if any) that were reasonable in the circumstances to ensure that the listed disclosing entity complied with its obligations under s 674; and
(b) after doing so, believed on reasonable ground that the listed disclosing entity was complying with its obligations under that subsection.

These provisions introduce a form of due diligence defence in respect of directors and other persons who might otherwise be liable for being involved in the listed entity's contravention.

Again, the existence of these provisions highlights the importance from a director's viewpoint, in ensuring that a listed company has appropriate corporate governance procedures and internal systems and processes in place to deal with information which might be price sensitive.

Chemeq

As outlined above, that decision identified a number of factors which may be of assistance in mitigating the penalty otherwise attracted to a company which has contravened the continuous disclosure provisions. That case emphasised the

importance of the existence of relevant policies and procedures as well as measures in places to ensure they are understood and applied, to demonstrate that an appropriate corporate culture is in place.

It does seem that presence of appropriate systems and policies not only minimises the risk of non-compliance, but will also potentially mitigate the penalties that otherwise might be applied.[61]

Directors should also note that establishing that a corporate culture exists promoting compliance may help to rebut the necessary fault element of an offence to sheet home criminal liability under s 12.3(1) of the *Criminal Code.*

SOME FOREIGN OBSERVATIONS

In recent times, many Australian companies have taken advantage of robust capital markets overseas as part of either a primary or secondary listing on a foreign stock exchange. When doing so, companies will need to be mindful of differences which may exist in foreign jurisdictions in the area of continuous disclosure.

United States of America

Curiously, United States securities legislation does not require continuous disclosure. Instead, companies operate under a system of quarterly reporting.[62] However, the Listing Rules of the NYSE, NASDAQ and American Stock Exchanges do contain listing rule obligations requiring companies to promptly disclose any material information.[63]

It may seem surprising to some that, despite the corporate excesses of the past which resulted in the *Sarbanes-Oxley Act 2002*, the disclosure obligation of United States listed companies still remain the subject of listing rule as opposed to statutory obligations. It has been said that Australia's corporate disclosure regime is in many respects much more advanced than that of the United States.[64] The source of much litigation in the United States in the area of disclosure has been r 10b-5 which was promulgated under the *Securities Exchange Act 1934*. That rule provides relevantly:

> "It shall be unlawful for any person, directly or indirectly…
> (b) to make any untrue statement of a material fact or to omit a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) …,
> in connection with the purchase or sale of any security."

[61] See also *ASIC v Southcorp Ltd (No 2)* (2004) 48 ACSR 187.
[62] See Cassidy and Chappele, "Australia's Corporate Disclosure Regime: Lessons from the US Model" (2003) 15 AJCL 1 at 2, 3.
[63] See, for example, NYSE Manual Section 202.05, NASD Manual 2002.
[64] See the Hon Peter Costello, Treasurer, Press Conference, Canberra 27 June 2002 at www.treasurer.gov.au.

Whilst the position with claims based on the making of untrue statements appears to have posed few difficulties, the cases of omission or non-disclosure have presented more evidentiary difficulties.[65]

Recent developments have made it easier for plaintiffs in cases of non-disclosure, to prove the necessary ingredient of reliance. The United States courts have embraced a doctrine in cases of non-disclosure whereby a presumption of reliance exists in cases of securities fraud based on non disclosure, often called the "fraud on the market" doctrine. This doctrine avoids shareholders having to prove they relied upon misleading information.[66]

Recent media reports suggest that this United States doctrine may be considered here as part of proposed further corporate law reform.[67] With the expansion of "investors" rights under the Sons of Gwalia decision,[68] it will be interesting to see how these new found "rights" are addressed in any mooted legislative reform in this area.

Canada

Security regulation in Canada is conducted on the provincial rather than federal level. The provinces have introduced various Securities Acts which impose a continuous obligation requiring reporting issuers to provide disclosure periodically about their business and affairs as well as provide disclosure of a material change.[69]

The Canadian approach appears to be to take a prescriptive approach to what constitutes a "material change" than that in Australia. Under the Ontario *Securities Act*, for example, a "material change" is defined to mean in relation to a company: "a change in the business, operations, or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer."[70]

This language is similar in scope and operation to the provisions in the United States under the Securities and Exchange Commission's r 10b-5. The provisions would appear to be far narrower in scope and operation than either LR 3.1 or s 674.

However it is noteworthy that Ontario in 2005 introduced new laws imposing greater liability in respect of improper continuous disclosure. The amendments will give security holders who buy or sell securities on a stock exchange or other secondary markets a statutory right to sue the company and its directors,

[65] See Duffy, "'Fraud On The Market': Judicial Approaches to Causation and Loss From Securities Non Disclosure in the United States, Canada and Australia" [2005] MULR 20.
[66] See *Basic v Levinson Inc* (1988) 485 US 224.
[67] See *Australian Financial Review* 21 September 2007 at p 3.
[68] (2007) 232 ALR 232.
[69] See for example, Pt 12 of the *Securities Act 1996* British Columbia s 85(B) and Pt XVIII of the *Securities Act 1990,* s 75(1).
[70] See s 1 *Securities Act 1990*.

management, controlling shareholders and others who knowingly influenced a director or an officer of the issuer to authorise, permit or acquiesce in improper disclosure.[71] These laws seem to open the door to class actions arising from non-disclosure.

However, it does seem that the Canadian approach to due diligence defences to contravention of disclosure obligations is more generous than that in s 674(2B) as it appears a defence will exist where a defendant shows:

- that he or she had conducted a reasonable investigation; and
- had no reasonable grounds to believe that timely disclosure would not be made.[72]

United Kingdom

The disclosure obligations of listed companies in the United Kingdom are the subject of either:

- both statutory disclosure rules and the Listing Rules of the UK Listing Authority in the case of companies listed on the London Stock Exchange (LSE); and
- in the case of companies listed on other markets such as AIM, the Listing Rules of that market.

In the case of the LSE statutory disclosure obligations on listed companies arise from disclosure rules enshrined into UK legislation, known as the Disclosure and Transparency Rules or DTR. If the company is listed on the LSE, it will be subject to the Listing Rules of the LSE together with the Disclosure Rules.

The Disclosure Rules came into force as a consequence of a European Union directive, which placed the obligation on member states to implement.[73] This was enshrined in statute under the UK *Financial Services and Markets Act 2000*.

The Disclosure Rules therefore apply to companies whose shares are admitted to the Official List and traded on the LSE, but not companies whose securities are quoted on AIM or companies with debt securities listed on the Professional Securities Market and which do not have shares or other securities traded on the LSE or another regulated market. The Disclosure Rules apply from the point at which the request or application for admission of the securities to trading is made to the LSE or other Recognised Investment Exchange.

In the case of companies listed on AIM, the disclosure obligations are those set out in the AIM Rules.[74] As a general observation the DTR and AIM Rules seem to take a more flexible and less stringent approach to continuous disclosure than

[71] See s 138(4).
[72] See s 138(6).
[73] See Transparency Directive (2004/109/EC).
[74] See AIM Rules for Companies r 11.

under either ASX Listing Rules or s 674, *Corporations Act*. The DTR imposes disclosure obligations on "inside information" which is defined by reference to the evaluation of information by a "reasonable investor", not a "reasonable person" as required under LR 3.1.[75]

Interestingly, the DTR contains specific guidance as to matters a "reasonable investor" ought to take into account in determining whether there is "inside information" requiring disclosure, and in doing so appears to recognise the difficulties in this exercise from case to case, even going to far to state that an issuer may require the help of its advisers to make an assessment of whether particular information amounts to "inside information".[76]

The obligation to disclose only requires disclosure "as soon as possible", rather than immediately as required under LR 3.1.[77] Interestingly, the obligation to disclose is not absolute as it is expressed to be subject to specific Disclosure Rules in DTR 2.5.2 which permit delay in disclosure.[78] This seems to afford far greater flexibility to UK listed companies as DTR 2.5.1 allows delay in disclosure in certain circumstances so as to not prejudice its legitimate interests.[79] This rule seems far more generous than the carve outs in LR 3.1A.

In the case of the AIM Rules, one observation that contrasts with the Australian position, is that the disclosure obligation is discharged by disclosure to the Nominated Adviser, rather than AIM itself. The approach to disclosure under the AIM Rules varies from the broad general obligation under LR 3.1 and a prescriptive approach is taken to what notifications are required to be made.[80] Notification is required of any major new developments in a company's sphere of activity which may lead to a substantial movement in the price of its securities.[81]

CONCLUSION

Listed entities in Australia are subject to broad continuous disclosure obligations arising under Listing Rules such as LR 3.1 and the provisions in s 674, *Corporations Act*. The disclosure obligations on their face are broader than counterparts in other jurisdictions where Australian companies have been active in recent times, including the United States, Canada and the United Kingdom.

[75] See DTR r 2.2.4.
[76] See DTR r 2.2.7.
[77] See DTR r 2.2.1.
[78] See DTR r 2.5.2.
[79] See DTR r 2.5.2(1),(2) and (3).
[80] See AIM r 11.
[81] In the UK liability for non-compliance with these disclosure obligations may arise under s 397, *Financial Services and Markets Act 2000* which creates an offence where any person knowingly or recklessly makes a statement, promise or forecast which is untrue, misleading or deceptive, or who dishonestly conceals material facts about the company. A person may be taken to be acting dishonestly for these purposes by deliberately or recklessly not complying with market practice or market regulation.

Additionally, amendments in recent years to the *Corporations Act* have extended the liability of companies for non-compliance at the same also extending potential liability for directors and others who are involved in contravention of the continuous disclosure obligations.

The regulatory balance has been tipped further in favour of the principal regulator ASIC through the availability of novel infringement notices which allow ASIC to act, in effect, as both prosecutor and judge in cases of alleged contravention of s 674.

The broad reach of this legislation as well as the cases that have arisen to date, give a clear indication that in this current era of ever increasing regulatory and investor vigilance on disclosure, it is increasingly important that companies implement and maintain policies which address and promote a culture of compliance with all disclosure obligations.

Failure to do so may result in increased corporate liability, loss of mitigating circumstances which may reduce liability, as well as a heightened exposure of directors and others involved in the disclosure process to liability for involvement in contravention of the continuous disclosure provisions.

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