

ENFORCEMENT OF CONTINUOUS DISCLOSURE IN THE AUSTRALIAN STOCK MARKET

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ABSTRACT

The statutory provision mandating continuous disclosure by listed companies was introduced on 5 September 1994 to support Australian Stock Exchange (ASX) listing rule 3.1. Statutory enforcement of this provision by the Australian Securities and Investments Commission (ASIC) remained dormant for many years with only limited application of the sanctions that followed the introduction of the *Corporations Act 2001* (Cth) and further amended legislation in 2004. However, heightened activity by ASIC in 2006 is evidence that the regulator and the Courts will now enforce the full range of penalties and remedies, from criminal proceedings to civil liability. Several cases are before the Courts as a result of legal action by the regulator and also by discontented company shareholders. This paper analyses recent enforcement activity and the possibility that litigation by shareholders against a listed company for a failure of relevant disclosure may provide an alternative to enforcement of continuous disclosure by ASIC.

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Enforcement of Continuous Disclosure in the Australian Stock Market

1 Introduction

From a slow beginning, the enforcement of continuous disclosure in the Australian stock market has gained pace. Increased awareness of the need for continuous disclosure by companies listed on the stock exchange, aided by revised legislation, has resulted in the recent completion of a number of enforcement proceedings and the initiation of others. A review of the statutory amendments and the resultant enforcement of continuous disclosure in Australia provide the motivation for this study. 2007 is an appropriate time for stocktaking as it is two decades since the formation of a national stock exchange, ASX Limited,¹ to facilitate electronic trading of securities in 1987. The first electronic trading of shares in the top listed companies began on 19 October 1987, a date better known as 'Black Monday', as over a period of seven weeks the market capitalisation of the Australian market fell by fifty per cent.² This crisis of confidence in the stock market prompted discussion of the need to revise legislation to better regulate insider trading and to demand greater compliance with the ASX rules of continuous disclosure.

In November 1991, the House of Representatives Standing Committee on Legal and Constitutional Affairs released a report entitled *Corporate Practices and the Rights of Shareholders*.³ To be known as the 'Lavarch Report', the Committee in 1990 had interviewed more than 50 witnesses from the leading accounting, securities and legal firms and organisations. As a result of these interviews, the Attorney General made a recommendation to the Federal Government in November 1991 that a regime of 'continuous disclosure' by listed companies should be 'introduced, implemented and enforced through the *ASX Listing Rules*'.⁴

CASAC's 1991 *Report on an Enhanced Statutory Disclosure System*,⁵ stated that a system of continuous disclosure, strengthened by statute, would promote investor confidence that was perceived to be at a low

¹ The Australian Stock Exchange Limited was formed on 1 April 1987 following the unification of the six state exchanges. The company officially changed its name to ASX Limited on 5 September 2006, to operate the 'Australian Securities Exchange' created by the merger of the stock exchange with the futures exchange, SFE Corporation Limited, effective in July 2006.

² The ASX All Ordinaries Index fell from 2300 on 21 September 1987 to 1150 on 11 November 1987. In one day the index fell by 25 per cent. Australian Stock Exchange *Annual Report 1987*, 13.

³ Parliament of the Commonwealth of Australia *Corporate Practices and the Rights of Shareholders* Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs Canberra AGPS November 1991 (Lavarch Report) at 17 par 1.3.29.

⁴ *Ibid*, at pxxii, Recommendation 12.

⁵ Companies and Securities Advisory Committee (CASAC) *Report on an Enhanced Statutory Disclosure System* Sydney September 1991 at 7. Hereafter referred to as CASAC (1991).

point following the 1987 market crisis. CASAC (1991) presumed a lack of informational efficiency as market forces failed ‘to guarantee adequate and timely disclosure by disclosing entities’. Such information, if disclosed, would lessen the possible distorting effects of rumour on a company’s share price and minimise opportunities for insider trading and other market abuses.⁶

Following these recommendations, the original statutory provision mandating continuous disclosure by listed companies was introduced on 5 September 1994 in order to support the ASX continuous disclosure listing rules. Statutory enforcement of this provision by the Australian Securities and Investments Commission (ASIC) remained dormant for many years, except for one instance of successful enforcement in 2003 following the introduction of the *Corporations Act 2001* (Cth). Further amended legislation in 2004 improved the range of ASIC’s powers and enabled the imposition of an infringement notice on one company in 2005. Heightened activity by ASIC since 2006 is evidence that the regulator and the Courts are now prepared to enforce the full range of penalties and remedies, from criminal proceedings to civil liability. To illustrate the increased concern for listed company compliance with disclosure rules, several cases are before the Courts as a result of legal action by the regulator and by discontented company shareholders. This paper analyses the recent enforcement activity. (See **Table 1**) The paper also explores the possibility that private litigation by shareholders against a listed company for failing to disclose relevant information may provide a viable alternative to the enforcement of continuous disclosure by ASIC.

Continuing, ongoing or voluntary corporate disclosure that is regulatory, but involves a degree of flexibility of timing and discretion on the part of directors and company officers, will mostly be referred to as ‘continuous disclosure’ throughout this article. This regulation exists to enforce further disclosure and to reappportion management information concerning the company to all stakeholders, including regulators, the public, potential investors and creditors, thereby overcoming information asymmetry. Relevant to any evaluation of a failure of continuous disclosure is the actual regulation and the effectiveness of its enforcement.

2 Legal Context of Continuous Disclosure

A company requesting admission to the official list of the Sydney stock exchange in the 1890s was required to agree to the condition that it must give prompt notification of all calls, dividends, alteration of capital, or other material information.⁷ This established the principle and the contractual obligation that a listed company must release material information to the market on an ongoing basis. As such, it is an

⁶ Ibid.

⁷ Salsbury S and K Sweeney *The Bull, the Bear and the Kangaroo: The History of the Sydney Stock Exchange* Sydney Allen & Unwin 1988, 203.

early forerunner of the continuous disclosure requirement. The listing rules were refined and a listed company had long been required under an earlier version of the ASX requirement 3A(1), to immediately notify the stock exchange of any information which would be likely to materially affect the price of its securities or is necessary to avoid the establishment of a 'false market' in the company's securities.⁸ The original continuous disclosure provision, s1001A of the *Corporations Law*, was implemented from September 1994, to mandate compliance with a revised ASX listing rule 3.1 that removed the 'false market' test. From 15 July 2001, the *Corporations Act 2001* (Cth) replaced the *Corporations Law*.

Both the statutory provision and the complementary ASX Listing Rules were amended and subject to further alteration with the implementation of CLERP 9.⁹ The revised listing rule 3.1, supported by the amended provision s674 with additional civil penalty remedies effective 11 March 2002, requires listed companies to notify ASX immediately if there is any information that 'a reasonable person would expect to have a material effect on the price or value' of the company's securities. ASX addressed the 'confidentiality' requirement of listing rule 3.1 by inserting 3.1A and reintroduced the need to prevent a 'false market' in 3.1B from 1 January 2003 to emphasise the fundamental obligation of the company to overcome the false market movements that can result from 'reasonable specific' media speculation or rumour.¹⁰ This amendment retains the 'carve-outs'¹¹ or exclusions from mandatory disclosure in certain circumstances but modifies the listing rule to allow ASX to ask the entity to 'give ASX the information needed to correct or prevent a false market'.¹² However, the responsibility lies with ASX to request the information under listing rule 3.1B.

⁸ Australian Stock Exchange Limited 'Proposed ASX Listing Rule Amendments Enhanced Disclosure' *Exposure Draft* 19 July 2002 1-130, at 55 states that ASX listing rule 3A requires: 'A listed company shall immediately notify the Exchange of - '1. Any information which – (a) is likely materially to affect the price of the securities of the listed company; (b) is necessary to avoid the establishment or continuation of a false market in the company's securities; or (c) investors and their professional advisors would reasonably require and reasonably expect to be disclosed to the market for the purpose of making an informed assessment of – (i) the assets and liabilities, financial position, profits and losses, and prospects of the listed company; and (ii) the rights attaching to the securities of the listed company.'

⁹ *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth): Schedule 6 Continuous Disclosure.

¹⁰ Australian Stock Exchange Limited 'Proposed ASX Listing Rule Amendments Enhanced Disclosure' *Exposure Draft* 19 July 2002 1-130, 44.

¹¹ A 'carve-out' or exception is possible if 'the information is confidential and ASX has not formed the view that the information is not confidential' and 'one or more of the following applies: it would be a breach of the law to disclose the information; the information concerns an incomplete proposal or negotiation; the information comprises matters of supposition or is insufficiently definite to warrant disclosure; the information is generated for the internal management purposes of the entity or the information is a trade secret. *ASX Listing Rules* 3.1A(2), (3),

¹² Australian Stock Exchange Limited 'Proposed ASX Listing Rule Amendments Enhanced Disclosure' *Exposure Draft* 19 July 2002 1-130 at 45, 49, Section 2 Continuous Disclosure 2.16, 3.1A.2; *ASX Listing Rules* 3.1, 3.1A and 3.1B, 1 January 2003.

Compliance with the ‘spirit’ of the rules is implicit in the wording of ASX listing rule 3.1 but it is stated explicitly, in the contract between the company and the ASX and in listing rule 19.2, that the Listing Rules are to be interpreted in accordance with their spirit, intention and purpose.¹³ ASX links the above mandate specifically with the requirements of listing rule 3.1 by repeating rule 19.2 in the guidance notes for continuous disclosure. This reinforces the demand that listing rule 3.1 should not be interpreted in a restrictive or legalistic manner but the company must comply in the ‘spirit’ of continuous disclosure:¹⁴ ‘The spirit of disclosure, of keeping the market fully informed of material information, runs through all of ASX’s Listing Rules...it is the key to market integrity.’¹⁵

3 ‘Responsive Regulation’ for Continuous Disclosure

The introduction of statutory support for continuous disclosure occurred as Ayers and Braithwaite, in their 1992 study on ‘responsive regulation’, initiated a debate concerning the stalemate between those who favour strong government regulation of business and those who advocate deregulation. This debate is appropriate to an ‘era of regulatory flux - an era when dramatic regulatory, deregulatory and re-regulatory shifts are occurring simultaneously’.¹⁶

The authors suggest that the ‘bigger and more various the sticks’ available to enforce regulation, the greater the success regulators will achieve by speaking softly.¹⁷ The stronger the moral suasion, the more effective regulation will be. They argue that more regulation can be effected through moral persuasion if sanctions for non-compliance are kept in the background. Regulation of the securities industry is viewed through a general philosophical framework. Ayers and Braithwaite advocate a mix of private and public regulation. Regulation needs to respond to industry conduct with a series of escalating forms of government intervention. These escalating forms will retain the benefits of *laissez-faire* governance without the regulator abdicating responsibility to correct market failure. They explain that:

¹³ *ASX Listing Rules* Appendix 1A ASX Listing Application and Agreement Part 3 clause 6, issued 3 May 2004; Chapter 19 Interpretation and Definitions introduced 1 July 1996, issued January 2003.

¹⁴ *ASX Listing Rules* Guidance Note on Continuous Disclosure par 26 issued 1 July 1996, replaced by Guidance Note 8 par 30 issued September 2001. Compliance with the ‘spirit’ of continuous disclosure now receives greater prominence under the heading *Continuous Disclosure - Best Practice* par 10 issued January 2003.

¹⁵ Australian Stock Exchange Limited *Continuous Disclosure - The Australian Experience* 20 February 2002, 4.

¹⁶ Ayers I and J Braithwaite *Responsive Regulation - Transcending the Deregulation Debate* New York Oxford University Press 1992, 7.

¹⁷ *Ibid*, 19.

...for the responsive regulator, there are no optimal or best regulatory solutions, just solutions that respond better than others to the plural configuration of support and opposition that exist at a particular moment in history.¹⁸

Responsive regulation provides a guide in the form of an explicit enforcement pyramid. In most cases compliance is encouraged by means of persuasion, supported by escalating severity for non-compliance. At the pyramid's pinnacle, a contravention incurs the harshest penalty. The six steps are, in ascending order of severity: persuasion, a warning letter, imposition of a civil penalty, criminal liability, suspension of the relevant licence and finally revocation of the licence.¹⁹ However, for these steps to prove an effective deterrent, 'the threat of escalation to serious levels of regulatory response must be credible'.²⁰

The greatest proportion of enforcement activity occurs at the base of the pyramid, with the pinnacle representing the regulator's 'benign big gun', which is the strongest but least used sanction. With the advent of civil and administrative penalties, continuous disclosure regulation manifests all the recommended steps of the enforcement pyramid. The order of the steps could differ if the action by the regulator is taken against an individual rather than a company. The position of steps 5 and 6 of the Ayers and Braithwaite model could be subject to debate in an Australian context. Prior to insertion of the predecessor of s674 into the *Corporations Act*, ASX's response to a non-compliant company was suspension of trading in the company's securities, the equivalent of step 5, or removal of the company from the Official List, the equivalent of step 6. From ASX's point of view these would have been the most likely actions taken after steps 1 and 2, the failure of both persuasion and a warning letter.

The enforcement pyramid illustrates a range of sanctions that are available when information is withheld from the market either by negligence or intent. Most economic models assume that a company has weighed the cost and benefit of compliance with the law before deciding not to comply, but this is not always the case. Although ignorance of the law is no defence, it can indicate a lesser sanction in a situation where directors of a company rely on the 'carve-outs' in listing rule 3.1 as '...they might know what the law is, but fail to grasp the fact that it applies in particular circumstances, or lose sight of this fact'.²¹

¹⁸ Ibid, 5.

¹⁹ Ibid, 35, 36.

²⁰ Dellitt C and B Fisse 'Civil and Criminal Liability under Australian Securities Regulation: The Possibility of Strategic Enforcement' 570-617, 580 in G Walker and B Fisse eds *Securities Regulation in Australia and New Zealand* Auckland OUP 1994.

²¹ Ayers I and J Braithwaite *Responsive Regulation - Transcending the Deregulation Debate* New York Oxford University Press 1992, 80.

4 Enforcement of Continuous Disclosure

The enforcement pyramid for the continuous disclosure would now seem to be complete. The continuous disclosure regime is defined by the three classes of penalties enforceable under Chapter 6CA of the *Corporations Act* as outlined in **Table 1**. A wide range of other remedies can also be utilised, as discussed later in this section.

4.1 General Penalty Provisions

Intentional or reckless contravention of the continuous disclosure rule by a listed disclosing entity is deemed an offence.²² The general statutory penalty provision, s1311(1), provides that a person who is guilty of an offence under Chapter 6CA²³ is punishable on conviction by a penalty, pecuniary or otherwise, as set out in Schedule 3 of the *Corporations Act*. For such an offence, the penalty is a fine and imprisonment for up to five years, or both.²⁴ For a failure to disclose, the company incurs primary liability under s674(2) and a corporate penalty under s1312.²⁵ Section 11.2 in Chapter 2 the *Criminal Code*²⁶ extends this criminal liability to any person who was directly or indirectly knowingly concerned with the offence.

The difficulty of successfully mounting a criminal prosecution suggests that the deterrent of criminal penalties has had little effect and the regulator has been constricted by the criminal standard of proof required for prosecution. It is difficult to prove the requisite level of criminal intent when companies defend non-disclosure by relying on the ‘carve-outs’ or exclusions under ASX listing rule 3.1A. To date, there has been no criminal conviction for a contravention of the continuous disclosure provision but the first proceedings to prosecute such an offence have been initiated by ASIC.

ASIC announced on 2 June 2006, that following a referral by ASX, the Commonwealth Director of Public Prosecutions intends prosecuting two former directors of Harts Australasia Limited in the Brisbane Federal Magistrates Court. Steven Hart, former Deputy Executive Chairman, and Richard Hayter, former

²² *Corporations Act 2001* (Cth), Section 674(2) Note 1: Offence see s1311(1).

²³ *Corporations Act 2001* (Cth), Section 1311(1A) Penalties in Schedule 3; s1311(2),

²⁴ *Corporations Act 2001* (Cth), Schedule 3 Penalties: 200 penalty units or imprisonment for five years or both. Section 1311(1A)(da) applies Schedule 3 penalties to Chapter 6CA Continuous Disclosure. A penalty unit is \$110 (s4AA(1) of the *Crimes Act 1914* (Cth)).

²⁵ *Corporations Act 2001* (Cth), Section 1312 penalties for bodies corporate are five times the maximum pecuniary penalty for that offence.

²⁶ Section 5 of the *Crimes Act 1914* (Cth) was repealed from the commencement of the *Criminal Code Amendment (Application) Act 2000* (Cth) on 15 December 2001 and the elements of s5 are replicated in s11.2 of the *Criminal Code*.

Managing Director of Harts Australasia Limited²⁷ are charged with a breach of the continuous disclosure obligation by being knowingly concerned²⁸ in Hart Australasia's failure to keep the market informed of the group's unexpected loss. The company had released to ASX on 25 January 2001 a revised financial forecast of a loss of \$9.7 million for the half-year to 31 December 2001. In October 2001, ASIC applied to the Supreme Court of Queensland for the appointment of liquidators to the company. The liquidators subsequently reported a corporate shortfall of \$60.8 million. Richard Hayter pleaded not guilty to the charge of breaching his disclosure obligation and on 21 September 2006, was committed to stand trial at a date to be fixed.²⁹

ASIC is taking this criminal action under the old s1001A of the *Corporations Law*, the continuous disclosure legislation effective at the relevant time in 2001. The breaches occurred prior to the introduction of the *Corporations Act* on 15 July 2001 and before civil and administrative sanctions were available to the regulator. The time limit for instituting criminal proceedings for an offence against the *Corporations Act* s1316 is the same as under the old *Corporations Law* and is five years after the alleged offence or at a later time if the Minister has given consent. Sections 1400 to 1402 of the current statute create equivalent criminal liabilities and time limits to the old legislation.

In contrast, the recent committal of Jim Selim,³⁰ former Chief Executive Officer and Managing Director of Pan Pharmaceuticals Limited, on 18 December 2006, ASIC initiated criminal proceedings against the appropriate company officer rather than against the company. The charges appear relate to the Chapter 9 offence of providing information known to be false or misleading (s1309(1)), rather than the Chapter 6CA breach of the continuous disclosure obligation. ASIC's initial enquiries in 2003 concerned a failure of continuous disclosure prior to a halt in the trading of Pan Pharmaceutical shares on 28 April 2003.³¹

²⁷ ASIC Media Release 06-176 'Former Harts Executives Charged with Continuous Disclosure Breach' 2 June 2006.

²⁸ *Crimes Act 1914* (Cth), s5 extended criminal liability to 'any person', for example directors, senior officers or advisers, who aided, abetted, counselled, procured or were directly or indirectly knowingly concerned with the offence. Although, s5 of the *Crimes Act* was repealed from the commencement of the Criminal Code on 15 December 2001, and is now essentially replicated in s11.2 in Chapter 2 of the *Criminal Code*, it is s5 that would apply to a breach committed in January 2001 and a 'penalty unit' at that time meant \$100 (*Corporations Law*, s9). Also, s674(2A) would not apply as it was only effective from 1 July 2004. This provision applies the civil penalties under s1317E to a contravention by an individual who is involved in the listed entity's contravention. 'Involved' is defined in s79.

²⁹ ASIC Media Release 06-333 'Former Harts Executive Committed for Trial on Continuous Disclosure Breach' 21 September 2006.

³⁰ ASIC Media Release 06-436 'Former Pan Pharmaceuticals CEO committed to stand Trial' 18 December 2006.

³¹ ASIC Media Release 03-138 'Pan Pharmaceutical' 29 April 2003.

4.2 Civil Penalty Provisions

Civil penalties were unavailable under the old s1001A but the *Financial Services Reform Act 2001*(Cth) extended the civil penalty regime to continuous disclosure in 2002. Section 674(2) Note 2³² nominates the subsection as a civil penalty provision under s1317E(1)(ja). A person who is involved in the listed company's contravention is also exposed to the civil penalty, subject to a due diligence defence.³³ This expanded regime offers another enforcement procedure in keeping with the 'responsive regulation' suggested by Ayers and Braithwaite and discussed earlier in this paper.³⁴

It was anticipated that expansion of the civil penalty regime, with its more attainable civil standard of proof, would be a greater deterrent to non-disclosure.³⁵ These new powers were first used by the regulator against Southcorp Limited. On 26 February 2003, ASIC filed proceedings in the Federal Court alleging a breach by Southcorp of its continuous disclosure obligations under the ASX Listing Rules and s674 of the *Corporations Act*. The breach concerned selective disclosure to analysts of information relevant to the company's forecast earnings. David Knott, then Chairman of ASIC, pointed out that: 'This is the first case of its type commenced by ASIC and will test the operation of both the ASX Listing Rules and the relevant provisions of the *Corporations Act*'.³⁶

ASIC sought a declaration and pecuniary penalty of \$200,000 under ss1317E(ja) and 1317G(1A) of the *Corporations Act*. These civil penalty provisions had only applied to a breach of the continuous disclosure obligation since 11 March 2002, approximately a month prior to the occasion of Southcorp's selective disclosure on 18 April 2002. The case was settled on 27 November 2003 when the Federal

³² Financial Services Reform Bill 2001, Schedule 2 Continuous Disclosure at 558; Note 2: s1317E Civil penalty provisions apply.

³³ *Corporations Act 2001* (Cth), Section 674(2A) Contravention by Individual Note 1: This subsection is a civil penalty provision. Section 674(2B) Due diligence defence applies if the person proves that they took all steps reasonable in the circumstances to ensure that the listed disclosing entity complied with its obligations and after doing so, believed on reasonable grounds that the listed disclosing entity was complying with its obligations under s674(2).

³⁴ Ayers I and J Braithwaite *Responsive Regulation - Transcending the Deregulation Debate* New York Oxford University Press 1992.

³⁵ Civil penalties were unavailable under s1001A but the amended continuous disclosure provision, *Corporations Act 2001* (Cth) s674(2), is a civil penalty provision under the extended s1317E(1)(ja). Civil penalties and compensation replace s1041I civil liability and provide an alternative to criminal liability and Schedule 3 penalties. Section 1317E was amended effective 11 March 2002.

³⁶ *ASIC Media Release* 03/070 'ASIC Files Proceedings against Southcorp' 26 February 2003: *ASIC News* March 2003 Issue 58, 1.

Court ordered Southcorp to pay a pecuniary penalty of \$100,000 plus ASIC's costs.³⁷ This was the first and only penalty imposed by the regulator under the legislation in the first decade of the continuous disclosure provision.

In early 2006, ASIC announced two further proceedings that it had initiated for breaches of s674. Following referrals from ASX, ASIC filed proceedings in the Federal Court in Perth on 23 December 2004 against Chemeq Limited³⁸ for continuous disclosure contraventions on seven occasions between February 2003 and 7 October 2004. ASIC sought a declaration of contravention of the civil penalty provision s1317E(ja) and a pecuniary penalty under s1317G(1A) of up to \$200,000 for each contravention prior to 1 July 2004. From that date, the introduction of the CLERP 9 amendments allowed the Court to impose a s1317G(1B)(b) financial services civil penalty of a maximum of \$1 million for a contravention by a body corporate. On 30 June 2006, ASIC announced that Chemeq has agreed it was appropriate for the Federal Court to declare that the company had contravened the provisions on two of the occasions and to impose pecuniary penalties. The Federal Court, on 24 July 2006, imposed a penalty of \$150,000 for the first contravention and \$350,000 for the second, which occurred after the amendments to the civil penalty provisions. Justice French did not impose the maximum penalty as the company had co-operated with ASIC and there was an absence of dishonesty. ASIC was awarded \$170,000 for costs to be paid by Chemeq.

In the second instance, announced in March 2006, ASIC is seeking civil penalties in the Federal Court in Perth of up to \$3 million against Fortescue Metals Group Limited and up to \$600,000 against Andrew Forrest, Chief Executive Officer,³⁹ for being knowingly concerned in the contraventions. It is alleged that the company failed its continuous disclosure obligations when it prematurely announced various contracts with Chinese entities on 23 August 2004 and 5 November 2004. ASIC also alleges that Fortescue was 'engaged in misleading and deceptive conduct' as it did not disclose that the parties had not reached a concluding agreement. On 27 April 2006, ASIC applied to the Court for leave to amend its claim, file a new statement of claim and seek additional orders against Fortescue Metals and Forrest.

³⁷ *ASIC Media Release 03/376 'Southcorp Settles with ASIC over Market Disclosure' 27 November 2003. Australian Securities and Investments Commission v Southcorp Limited (No 2) [2003] FCA 1369 (27 November 2003).* This penalty was half the maximum applicable at the time, but it did anticipate the maximum \$100,000 penalty that would be payable by a *Tier 1 entity* once Infringement Notices were introduced from 1 July 2004, as discussed below at 3.3.

³⁸ *ASIC Media Releases 04-426 'ASIC Takes Action against Chemeq' 23 December 2004; 06-214 'ASIC Reaches Settlement in Civil Proceedings against Chemeq Limited' 30 June 2006; 06-246 'Chemeq Limited ordered to pay \$500,000 in fines for Breach of Continuous disclosure provisions' 25 July 2006.*

³⁹ *ASIC Media Releases 06-062 'ASIC Commences Proceedings against Fortescue Metals Group Limited and Andrew Forrest' 2 March 2006; 06-130 'ASIC Files New Statement of Claim against Fortescue Metals' 27 April 2006.*

4.3 Infringement Notices

ASIC supported the concept of an enforcement pyramid and access to a wider range of enforcement options. Recommendation 12 of the CASAC (1996) report⁴⁰ suggested that ASIC should have the power to impose a small administrative penalty of approximately \$5,000 for a minor contravention without application to the Court. This would offer an alternative to civil or criminal penalties.

The lack of flexibility for the regulator to impose fines for continuous disclosure contraventions without reference to the Courts, similar to those granted to the Financial Services Authority in the UK,⁴¹ was considered the main reason for the dearth of Chapter 6CA sanctions against listed companies. The Commission's inaction against a leading mining company for breach of the continuous disclosure rules occurred in spite of advice from senior counsel that there was an arguable case. The decision not to proceed was weighted by 'considerable doubt that any effective remedy is available to ASIC under the Corporations Act'.⁴² As the Chairman of ASIC stated: 'This case further highlights the need to review the sanctions available to the ASX and ASIC to underpin disclosure.'⁴³

The regulator believed that the *Southcorp* case, discussed at 4.2 above, focused attention on the need for a 'more streamlined process for dealing with disclosure matters.'⁴⁴ This was achieved by granting ASIC the power to impose administrative penalties. Such amendments were proposed in the CLERP 9 agenda and commenced on 1 July 2004.⁴⁵ The continuous disclosure provision was now followed by Note 3, which stated that an infringement notice could be issued under s1317DAC for an alleged contravention of s674(2). The infringement notice and penalties were inserted as Part 9.4AA, prior to the civil penalty provisions in Part 9.4B. ASIC had attained the right to impose an administrative financial penalty for a breach of the continuous disclosure rule, similar in some respects to that of the UK regulator but without

⁴⁰ Companies and Securities Advisory Committee (CASAC) *Report on Continuous Disclosure* Sydney November 1996 Appendix 8 at 42, 43. Hereafter CASAC (1996).

⁴¹ *ASIC Media Release* 01/283 13 August 2001; Knott D 'Launch of the Australasian Investor Relations Association' Speech by the Chairman, ASIC 13 August 2001, 3-4.

⁴² *ASIC Media Release* 'ASIC Concludes Investigation into WMC Ltd' 02/79 7 March 2002, 1.

⁴³ *Ibid.*

⁴⁴ *ASIC Media Release* 03/070 'ASIC Files Proceedings against Southcorp' 26 February 2003.

⁴⁵ CLERP 9 *Corporate Disclosure: Strengthening the Financial Reporting Framework* Commonwealth of Australia, Treasury, Canberra 18 September 2002 1-194, 147-149; Australian Securities and Investments Commission 'Submission on CLERP 9 *Corporate Disclosure: Strengthening the Financial Reporting Framework*' November 2002 1-51 Proposal 22 at 34; *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*: Schedule 6 Continuous Disclosure.

the wider penalty discretion available to the Financial Services Authority.⁴⁶ Compliance with the infringement notice and payment of the penalty is not an admission of guilt or civil or criminal liability, as provided under ss1317DAF(4) and 1317DAJ(3)(b), and the company is not regarded as having contravened s674(2). The company is usually an entity listed on the stock exchange, in which case ASIC must consult with the ASX and consider the exchange's relevant Listing Rules and guidelines,⁴⁷ namely ASX listing rule 3.1 and Guidance Note 8. Most actions taken by ASIC for breaches of continuous disclosure will originate with referrals from ASX under its s792A obligations as a market licensee to maintain a fair and transparent market.

The power to issue an infringement notice was exercised for the first time when ASIC issued a notice to Solbec Pharmaceuticals Limited⁴⁸ on 23 November 2004. Occurring a year after the civil penalty settlement against Southcorp Ltd, the infringement notice to Solbeck is the only other Chapter 6CA sanction finalised before 2006. Solbeck failed to notify ASX about the structure, size and limited nature of the results of an animal study relating to its cancer drug. Solbec elected to comply with the notice and on 1 August 2005 it paid the \$33,000 penalty of a *Tier 3 entity*.⁴⁹

Subsequently in 2006, three other companies also paid the specified penalty of \$33,000. QRSciences Holdings Limited⁵⁰ complied with an infringement notice issued by ASIC on 20 December 2005. The company failed to notify ASX of the withdrawal on or about 31 January 2005 by Ord Minnett Limited from a commitment to underwrite QRS options. On the 23 February 2005, SDI Ltd announced an annual profit forecast of \$9.1 million but it failed to announce an amended expected profit of only \$4 to \$5 millions until 11 May 2005, despite low monthly returns in January, February and March. The regulator asserted that: 'Listed companies that choose to make a profit forecast must ensure that they have adequate systems to monitor their ongoing performance against those forecasts.'⁵¹ Avastra Limited⁵² also

⁴⁶ *ASIC Media Release* 01/283 13 August 2001; Knott D 'Launch of the Australasian Investor Relations Association' Speech by the Chairman, ASIC 13 August 2001, 3, 4; CLERP 9 above at 147; UK Listing Authority *Listing Rules* 1 December 2001 Chapter 1 pars 1.8, 1.9; *Financial Services and Markets Act 2000* (UK) ss123(1)(a), 123(1)(b).

⁴⁷ *Corporations Act 2001* (Cth), ss1317DAD(2), 1317DAC(4).

⁴⁸ *ASIC Media Release* 05-223 'ASIC Issues First Infringement Notice for Continuous Disclosure Breach' 1 August 2005.

⁴⁹ *Corporations Act 2001* (Cth), ss1317DAE(2), (6), categorises the company as a *Tier 3 entity* if the market capitalisation did not exceed \$100 million.

⁵⁰ *ASIC Media Release* 06-042 'ASIC Disclosure Penalty for Perth Company' 17 February 2006.

⁵¹ *ASIC Media Release* 06-124 'Melbourne Company pays Disclosure Penalty' 21 April 2006.

⁵² *ASIC Media Release* 06-156 'Sydney Life Sciences Company pays Disclosure Penalty' 15 May 2006.

complied with an infringement notice issued by ASIC on 18 April 2006. Despite becoming aware on 26 April 2005 that the clinical trial results of the company's Bioweld Tube technology would not be known until the end of 2005, the company did not disclose the information to ASX until 13 May 2005.

In July 2006, Astron Limited, paid the higher specified penalty of \$66,000.⁵³ This followed the claim by ASIC that the company became aware on the 6 January 2006 of a significant increase in the mineral resource estimate for one of its projects. Disclosure was not made to the market until 12 January 2006. Although Astron is the fifth company to pay an infringement notice penalty, it is the first to pay the higher amount calculated for a *Tier 2 entity*.

As the above examples indicate, s1317DAJ(1) enables ASIC to publish details of a disclosing entity's compliance with an infringement notice. We do not know if there are other examples of compliance that have not been made public. However, in the case of non-compliance, there is nothing to prevent the Court from imposing a higher penalty and in such a situation proceeding under the civil penalty provisions of Part 9.4B would be commenced.⁵⁴ ASIC avoided such action and stated that it would not proceed down this path when it concluded its investigation concerning Telstra's suspected contraventions of the continuous disclosure provisions between 11 August and 6 September 2005. Although the regulator found Telstra's practices unacceptable, they 'fell short of being appropriate for Court proceedings'.⁵⁵ ASIC was concerned that Telstra would refuse to pay the \$100,000 calculated for a *Tier 1* infringement notice and ASIC would be forced to move to civil penalty proceedings.⁵⁶

4.4 Civil Liability Remedy

2006 also produced the first example of civil damages for a failure to disclose, exactly 12 years after the introduction of the continuous disclosure provision. On 6 September 2006, Master Sanderson in the Supreme Court of Western Australia awarded damages of \$1.856 million to a private plaintiff for the negligent failure by Jubilee Mines NL⁵⁷ to notify ASX of certain material information required under the

⁵³ *ASIC Media Release 06-242 'Chemical Company pays \$66,000 Penalty'* 18 July 2006. Under s1317DAE(2)(b) Astron's penalty is that calculated for a *Tier 2 entity* under s1317DAE(6)(a)(ii). This category applies to an entity if its market capitalisation is more than \$100 million but does not exceed \$1,000 million.

⁵⁴ *Corporations Act 2001* (Cth), ss1317DAB(2)(c), 1317DAG(2).

⁵⁵ *ASIC Media Release 05-391 'ASIC warns Telstra on Disclosure Procedure'* 14 December 2005.

⁵⁶ Crowe D 'Too Fearsome a Foe for ASIC' *Australian Financial Review* 17 February 2006, 18; Baxt R 'Editorial' (2006) 24(2) C&SLJ 73-74. Under s1317DAE(2)(a) Telstra's penalty would be that calculated for a *Tier 1 entity* under s1317DAE(6)(a)(ii). This category applies to an entity if its market capitalisation exceeds \$1,000 million.

⁵⁷ *Kim Riley in his capacity as Trustee of the Ker Trust v Jubilee Mines NL* [2006] WASC 199.

old listing rule 3A. The action arose under the original s1001A(2) as Jubilee Mines was negligent in not disclosing potential nickel deposits at its McFarlanes Find tenement in the period September to October 1994. This was only a matter of weeks after the legislation was effective on 5 September 1994. The former s1005 provided damages for a person who suffered a financial loss from a contravention of Part 7.11 of the *Corporations Law* if the action was commenced within six years of this contravention.

4.5 Other Enforcement Mechanisms

CASAC (1996) recommended that ASIC should have the power to demand enforceable undertakings regarding an information processing system, or any other remedial action, to be implemented by a disclosing entity. ASIC argued that this wider range of enforcement options, rather than reliance on civil or criminal litigation, would encourage compliance with continuous disclosure.⁵⁸ This particular type of ‘enforced self regulation’ is in keeping with the principles of Ayers and Braithwaite’s enforcement pyramid. Section 93AA of the ASIC Act⁵⁹ introduced a provision for enforceable undertakings by companies from 1 July 1998. Under the provision, the Commission may accept a written undertaking from a person in connection with any matter that is within ASIC’s power. There is no set period of enforcement and the undertaking can be varied or withdrawn at any time with ASIC’s permission.

ASIC can seek a Court order to enforce compliance if the undertaking is breached. An enforceable undertaking can be a flexible and timely regulatory alternative to civil or administrative proceedings by the Commission.⁶⁰ ASIC elicits a certain degree of peer pressure to enforce the undertaking by exposing the relevant person, or company, to the rigour of detailing the undertaking on a public register. The publication of these undertakings is a key element in the successful enforcement of the agreements. Public awareness of the undertaking by peer companies and investors should stimulate compliance by the delinquent company.

One of the initial undertakings was accepted from Crown Casino in response to evidence of the company’s inadequate continuous disclosure policy in early 1998. Crown Casino agreed to ‘report quarterly to the market and establish an internal compliance plan and manual’.⁶¹ A recent 2006

⁵⁸ CASAC (1996), 42, 43.

⁵⁹ *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act).

⁶⁰ Statement by ASIC Commissioner Jillian Segal in *ASIC Media Release 98/343* 12 November 1998; *ASIC Practice Notes PN69* 7 April 1999 Part A.

⁶¹ *ASIC Media Release 98/277* 11 September 1998 and *98/343* 12 November 1998 concerning Crown Casino Limited.

application of this remedy followed the failure by the Multiplex Group⁶² to meet its continuous disclosure obligations. ASIC accepted an enforceable undertaking from the company and secured a \$32 million compensation fund. Compensation will be available to investors who purchased and held Multiplex shares in the period prior 24 February 2005 when the company disclosed a material change of profit on the Wembley National Stadium project in London.

Shareholders who accept this offer of compensation will waive their right to participate in a class action initiated by Multiplex investors for losses of approximately \$100 million suffered as a result of the company's non-disclosure. On the 21 December 2006, Multiplex stated that it intended to vigorously defend this action.⁶³ In a further example of shareholder initiated proceedings, investors filed a class action for damages of approximately \$300 million against Telstra in January 2006.⁶⁴ This follows the regulators failure to issue and infringement notice against the company for a failure to meet its continuous disclosure obligations, as discussed earlier in this paper at 3.3.

4.6 ASX Enforcement

The statutory enforcement offered for the listing rules, and particularly rule 3.1, is designed to support the role of the stock exchange. Theoretically, ASX, as did its predecessors, writes the listing rules that govern those companies whose securities are traded on the stock market. However, under s793E(3), (4) the Minister may disallow amendments to the rules if they will not ensure 'a fair, orderly and transparent market' (s792A(a)). This independence of the stock exchange exists in close cooperation with ASIC, particularly since the insertion of s798C, which allowed ASX to be included on its own Official List in October 1998.⁶⁵ This was followed by the formation of ASX Supervisory Review Pty Ltd (ASXSR) from March 2001 to provide surveillance of the regulatory functions of ASX.⁶⁶ The Senate Economic References Committee recognised this potential conflict between ASX's commercial interest as a listed

⁶² *ASIC Media Release* 06-443 'ASIC accepts and Enforceable Undertaking from the Multiplex Group' 20 December 2006.

⁶³ Wilmot B 'Multiplex to face \$100 million Class Action' *Australian Financial Review* 18 December 2006, 3. ASX Company Announcement 'Multiplex Class Action' 21 December 2006.

⁶⁴ Black A 'Corporate Class Actions in Australia' *Mallesons Stephen Jaques* 1-9 at 1, 15 June 2006. Crowe D 'Too Fearsome a Foe for ASIC' *Australian Financial Review* 17 February 2006, 18. *ASIC Media Release* 05-391 'ASIC warns Telstra on Disclosure Procedure' 14 December 2005.

⁶⁵ ASX was demutualised on Tuesday 13 October 1998 and its securities were listed for trading on its own stock market from the following day. ASX is directly supervised by ASIC with respect to its compliance with ASX listing rules. *ASIC Media Release* 98/292 23 September 1998; ASX website.

⁶⁶ *ASIC Media Release* 'ASIC Welcomes New Oversight Responsibilities for Market Operators' 00/466 9 November 2000; *ASX Media Release* 'ASX's Supervisory Arrangements' - Richard Humphry, Managing Director ASX, released details of the establishment of ASX Supervisory Review Pty Ltd at a Securities Institute Corporate Briefing, 9 November 2000. *Australian Stock Exchange Limited Report to Shareholders 2000/2001*, 31.

company and its supervisory responsibilities but it considered that: ‘...ASX should be given a period of time to demonstrate that initiatives such as ASXSR are sufficient to address the conflicts of interests issues.’⁶⁷ ASXSR ceased operations following the establishment on 1 July 2006 of ASX Markets Supervision Pty Ltd (ASXMS) as a further step in ‘providing a market of integrity’.⁶⁸

The stock exchange has a positive duty to provide all reasonable assistance to ASIC in the performance of its duties. These provisions apply if the stock exchange believes that a person has committed, or is about to commit, a serious contravention of a listing rule or the *Corporations Act*. In this event, it must as soon as practicable lodge with ASIC a statement of the particulars of the contravention.⁶⁹

In the past, ASX could be deterred from taking action to enforce its listing rules. There was a latent concern that a disaffected company could sue for defamation if ASX published information that was later found to be incorrect. The *Corporations Act* gives ASX the right to institute proceedings for contravention of the rules under ss793C and 1101B without having to give an undertaking as to damages. ASX would also be protected by s1100B qualified privilege when it takes appropriate action concerning any continuous disclosure released under listing rule 3.1.

5 Conclusion

The *Corporations Act* Chapter 6CA on continuous disclosure has the advantage of efficiency with its pyramid of sanctions; criminal, civil and administrative are all noted under the main provision, s674. ASIC has attained the ability to impose the payment of infringement notices but not the discretion to nominate the penalties as these are confined by statute. By default, ASIC must resort to the civil penalty regime if a company refuses to pay an infringement notice. Also, ASIC must apply to the Court for a declaration with regard to civil penalties for continuous disclosure and again the maximum penalties are set by statute. The Australian legislation was initially formulated to consider the disclosing entity as the proper subject for the financial penalty, by implication placing the responsibility for disclosure on the board and management as a whole. More recently, in still unresolved actions against officers of Harts Australasia and Fortescue Metals Group, ASIC has shown that it is more prepared to take both criminal and civil penalty proceedings against a person who is knowingly concerned or involved in the

⁶⁷ Parliament of Australia, Senate Economics References Committee *Inquiry into the Framework for the Market Supervision of Australia’s Stock Exchanges* 11 February 2002 Executive Summary and Findings, xvii.

⁶⁸ *ASX Media Releases* ‘ASX markets Supervision: new Structure to operate from 1 July’ 29 June 2006; ‘ASX Markets Supervision assumes responsibility for ASX Supervisory Review’ 9 October 2006.

⁶⁹ Sections 792D, 792B.

In the Report⁷⁰ submitted prior to the CLERP 9 amendments, the Parliamentary Committee recommended that there should be a review of the infringement notice provisions two years after they came into force. Further, it recommended that in light of comments suggesting that ASIC is not fully or effectively using its current powers to enforce the continuous disclosure provisions,⁷¹ the review could take a broader approach and examine the effectiveness of the enforcement regime for continuous disclosure as a whole, including the criminal and civil provisions. This would be an opportunity to reconsider the lack of proximity of Chapter 6CA to other closely related market abuses and insider trading in Chapter 7 Part 7.10. Even with the full enforcement pyramid of deterrent sanctions, the Australian market still requires a positive ‘culture of disclosure’ on the part of listed companies rather than the more negative ‘culture of compliance’ that now exists.⁷²

⁷⁰ Parliamentary Joint Committee on Corporations and Financial Services ‘Senator Chapman Tables Part 1 of Report on CLERP 9’ *Media Release* 4 June 2004 at 14: Recommendation 17 (6.112) and Recommendation 18 (6.134).

⁷¹ Baxt R ‘Editorial’ (2006) 24(2) C&SLJ 73-74: ‘It may be argued by ASIC that it is now appropriate to review the retention of this controversial infringement notice power which ASIC says that it is unable to use effectively. In my view the power should be repealed.’

⁷² Australian Stock Exchange Limited *Continuous Disclosure – The Australian Experience* 20 February 2002, 1.

**Table 1: Chapter 6CA Continuous Disclosure Enforcement
to 25/9/2006**

	Company/Individual	Date of Breach	Date Final	Penalty Applied	Legislation
4	Enforcement of Continuous Disclosure				
4.1	<u>General Penalty Provisions 5/9/1994 (Offence)</u>				
	Steven Hart (Harts Australasia Limited)	25/01/2001		Individual	s1001A(3)
	Richard Hayter (Harts Australasia Limited)	25/01/2001		individual	s1001A(3)
4.2	<u>Civil Penalties Provisions 11/3/2002</u>				
	Southcorp Ltd	18/04/2002	27/11/2003	\$100,000/company	s674(2) Note 2
	Chemeq Limited	10/02/2003	24/07/2006	\$150,000/company	s674(2) Note 2
	Chemeq Limited	07/10/2004	24/07/2006	\$350,000/company	s674(2) Note 2
	Fortescue Metals Group Ltd	23/08/2004		company	s674(2) Note 2
	Andrew Forrest (Fortescue Metals Group Ltd)	23/08/2004		individual	s674(2) Note 2
4.3	<u>Infringement Notices/Penalties 1/7/2004</u>				
	Solbec Pharmaceuticals Ltd	23/11/2004	01/08/2005	\$33,000/company	s674(2) Note 3
	QRSciences Holding Limited	31/01/2005	17/02/2006	\$33,000/company	s674(2) Note 3
	SDI Ltd	11/05/2005	21/04/2006	\$33,000/company	s674(2) Note 3
	Avastra Limited	26/04/2005	15/05/2006	\$33,000/company	s674(2) Note 3
	Astron Limited	06/01/2006	18/07/2006	\$66,000/company	s674(2) Note 3
4.4	<u>Civil Liability Remedy 5/9/1994 (Negligence)</u>				
	Jubilee Mines NL	Sept/Oct 1994	06/09/2006	\$1.856million/company	s1001A(2), s1005

Note: Corporations Law s1001A(2) Damages for negligence s1005; s1001A(3) contravention an offence if intentional or reckless.
Corporations Act 2001 (Cth) s674 Continuous Disclosure Note 1 s1311 and Schedule 3; Note 2 ss1317E-G ; Note 3 ss1317DAC-DAF.