Law Council
OF AUSTRALIA

Mr Kevin Lewis
Group Executive & Chief Compliance Officer
ASX Limited
Exchange Centre
20 Bridge Street
Sydney, NSW, 2000

16 December 2011

Dear Mr Lewis

Continuous disclosure

I refer to the meeting in October 2011 between representatives of ASX and the Corporations Committee of the Business Law Section of the Law Council of Australia regarding continuous disclosure. I thank you for the opportunity to make this submission which has been prepared by the Corporations Committee.

We understand from the ASIC Report 222, "Market assessment report: ASX group" November 2010 and subsequent discussions with ASX that ASX has initiated a review of Guidance Note 8 on continuous disclosure "to ensure that it remains current in light of recent market conditions and disclosure practices"[1] and agreed to establish an ASX-ASIC working group for the purposes of advancing joint initiatives on better disclosure for investors.[2]

We understand that you are considering a number of areas, including the following, in which to clarify guidance, subject to internal review processes.

- Linkages between Listing Rule 3.1, and the Corporations Act, including sections 180, 674, 1309, 1041E and 1041F.
- The meaning of "immediate" and the use of trading halts to manage the disclosure obligation.

[1] At para 18.
[2] At para 19.

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

- Misleading announcements and earnings guidance.
- Guidance about the impact of prior announcements on disclosure obligations.
- The reasonable person carve out, including examples of what might be and might not be expected to be disclosed.
- Guidance on the standard of materiality.
- Practical hints (eg having a draft announcement available to request a trading halt if an entity is involved in a transaction).

We support the proposal to clarify the operation of Listing Rule 3.1 and provide additional guidance. Some of the areas you mention accord with our initial thoughts on where further clarity could be provided. We also have identified some additional areas.

We understand that it is not intended to make substantive changes to Listing Rule 3.1, nor to make changes that may impact on the operation of section 674 of the Corporations Act. Some of our proposals identify changes to the Listing Rule as desirable, but could also be implemented to some extent through changes to the Guidance Note (possibly followed by a later Listing Rule amendment). Some of the proposals are for more substantive Listing Rule (or Corporations Act) amendments.

Accordingly, we appreciate that while ASX may be prepared to consider some of our proposals in the form of changes to the Guidance Note, we also need to make submissions to Treasury and ASIC to pursue the more substantive changes. So that ASX, Treasury and ASIC receive a consolidated set of proposals, we have structured this submission in a form that can be copied to Treasury and ASIC for consideration of the more substantive changes, as follows.

1. Background.
2. Changes that can be effected through Guidance Note change or change in ASX practice.
3. Changes that would require substantive Listing Rule or Corporations Act amendment.
4. Summary.

The issues raised in this submission were identified through a working group comprising representatives from across national law firms and listed entities, bringing together their experience in the operation of the continuous disclosure provisions since the introduction of the current form Listing Rule 3.1 (and earlier).

1. Background

There are two key principles on which the Listing Rules are based that are relevant to disclosure. First, that "timely disclosure must be made of information which may

affect security values or influence investment decisions, and of information in which security holders, investors and ASX have a legitimate interest" (chapter 1 of the Listing Rules). Second, that "the highest standards of integrity, accountability and responsibility of entities and their officers must be maintained" (chapter 1 of the Listing Rules).

We acknowledge that the continuous disclosure rules in Australia are an important component of the corporate regulation regime designed to ensure the integrity of the ASX market[3] and, overall, we believe operate as intended.

However, there are some aspects of the continuous disclosure rules that cause difficulties for listed entities and their officers and could, we believe, be improved.

Before discussing these, we observe that the context in which continuous disclosure rules operate has changed significantly since the current form (in substance) of Listing Rule 3.1 was introduced in September 1994 (then Listing Rule 3A(1)).

1.1 Introduction of revised continuous disclosure Listing Rule and statutory backing

The following points in relation to the changes introduced in 1994 are noted.

- The Listing Rule was introduced against a background of considerable debate about whether the continuous disclosure regime should be in the Listing Rules with ASX as the "front-line" regulator or as a statutory scheme administered by ASIC.[4] This debate was resolved at the time in favour of regulation in the Listing Rules, administered by ASX. However, the Rule was given "statutory backing".
- At the time, statutory backing was under section 1001A of the Corporations Act. In essence it imposed a prohibition on "intentionally, recklessly or negligently" failing to comply with the Listing Rule (section 1001A(2)). A person who suffered loss or damage could recover that amount by action

[3] Noted judicially by the Court of Appeal of the Supreme Court of New South Wales in *James Hardie Industries NV v ASIC* (2010) 274 ALR 85, at para 355: "The continuous disclosure regime, contained in s 674 and the Listing Rules, is designed to enhance the integrity and efficiency of Australian capital markets by ensuring that the market is fully informed. The timely disclosure of market sensitive information is essential to maintaining and increasing the confidence of investors in Australian markets, and improving the accountability of company management. It is also integral to minimising incidences of insider trading and other market distortions."

[4] This debate is reflected in the following material: "Report on an Enhanced Disclosure System", CAMAC, September 1991; "Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, Corporate Practices and Rights of Shareholders", November 1991 (Lavarch Report); Government Response the Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, 1992; *Corporate Law Reform Bill (no 2) (Duffy bill); Corporate Law Reform Bill 1993 & 1994* (Lavarch Bill).

against the disclosing entity or any person involved in the contravention (section 1005, section 79).

- In addition, the disclosing entity had criminal liability if the contravention was "intentional or reckless" (section 1001A(3)) – with a maximum penalty of $100,000. Officers and other involved persons may have criminal liability as accessories (Crimes Act section 5, if the person had knowledge of the essential matters which go to make up the offence, whether or not the person knew the matter amounted to a crime) – with a maximum penalty of $20,000 and/or five years imprisonment.

1.2 Subsequent developments

1.2.1 Financial Services Reform Act 2001

The *Financial Services Reform Act 2001* introduced a number of changes from 11 March 2002.

- The statutory provisions were moved into new Chapter 6CA of the Act.
- The provisions were made financial services civil penalty provisions so that a contravention by a disclosing entity gave rise to exposure to a civil penalty (section 1317E). The maximum penalty at the time was $200,000.
- A statutory breach was no longer limited to "intentional, reckless or negligent" contraventions of the Listing Rule. Accordingly, for civil liability, strict liability rather than fault-based liability was introduced.
- For criminal liability, the Criminal Code was applied under section 678, and as a fault element is no longer specified in the section (now section 674), the default fault element applies (Criminal Code section 5.6). Applying this to the 'failure to notify' element of the offence means that the disclosing entity is liable if the failure is intentional and, probably, if reckless.[5]

1.2.2 Listing Rule amendments 2003

ASX introduced amendments to the Listing Rules on 1 January 2003.

- A false market test was reintroduced – if ASX considers there is a false market and asks for information, the disclosing entity must give ASX the information needed to correct or prevent the false market (Listing Rule 3.1B).
- Information is only treated as confidential for the purposes of the carve out provisions if ASX has not formed the view the information has ceased to be confidential (Listing Rule 3.1A.2).

[5] See Bloch, M, Weatherhead, J and Webster, J, "The development and enforcement of Australia's continuous disclosure regime", (2011) 29 C&SLJ 253, at paras 265-266.

- ASX may publish correspondence between it and a disclosing entity if ASX has reserved the right to do so and considers it necessary for an informed market (Listing Rule 18.7A). The Listing Rule includes a note giving as an example of the application of this rule, the publication of correspondence in relation to price queries and compliance.

1.2.3 Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 1994

Further amendments were made to the Corporations Act by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 1994* from 1 July 2004.

- This introduced section 674(2A) which provides that a person involved in a listed disclosing entity's contravention contravenes that section, together with a limited due diligence defence in section 674(2B).
- Officers and others are exposed to the civil penalty regime (section1317E), with a maximum penalty of $200,000.
- The maximum civil penalty for disclosing entities was increased to $1 million.
- An infringement notice regime was introduced allowing ASIC to issue an infringement notice and agree the imposition of a financial penalty with the disclosing entity.

1.2.4 The development of class actions in the context of continuous disclosure

Another change has been the development of class actions. In making the observations below, it is not intended to detract from the role private enforcement actions can play in providing access to justice, but to observe that their development has changed the landscape within which continuous disclosure operates.

- Since the introduction of Pt IVA to the Federal Court of Australia Act 1976 (Cth) in 1992, there have been approximately 250 class actions. Although the initial growth was modest, in recent years the frequency of shareholder class actions (**SHCAs**) has risen significantly to the point where SHCAs now comprise approximately 25% of all class action claims filed in the Federal Court. This growth has been driven by the development of the Australian third party litigation funding industry led by IMF (Australia) Ltd. Of the 13 shareholder class actions that have concluded in the Federal Court to date, nine have settled for a collective amount of approximately $550 million.

- SHCAs are typically commenced by private institutional shareholders (rather than regulators such as ASIC[6] or ASX). They are traditionally based upon allegations that, in breach of its continuous disclosure obligations under section 674(2) and Listing Rule 3.1, a listed entity failed to disclose price sensitive (or 'material') information to the market in a timely fashion. It is commonly alleged that, due to this failure, the entity's share price was 'inflated' above the value it would have been but for the contravention.[7] The class is comprised of shareholders who acquired securities at an inflated level and seek compensation for the amount of the inflation.
- As a consequence of the growth of SHCAs and the significant cost associated with defending and/or settling such litigation, compliance with continuous disclosure obligations is no longer solely part of a listed entity's regulatory environment. Decisions with respect to the disclosure of information to the market now carry a heightened risk of scrutiny as part of a SHCA.
- SHCAs are traditionally brought against the entity with the disclosure obligations. However, there have also been SHCAs in which officers of a company have been joined to the proceedings either directly by plaintiffs or through cross-claims brought by third parties who themselves have been joined to the proceedings (eg auditors). Even if officers are not formally joined to the proceedings, some will likely still be involved as witnesses of fact throughout the proceedings.
- SHCAs are often commenced on the strength of limited publicly available information including disclosures made by the listed entity and evidence regarding the reaction of the market to such disclosures. Plaintiffs will traditionally point to a significant share price decline following a particular disclosure to demonstrate that material information has been released to the market and will allege, based on other publicly available information, that the material information should have been disclosed at an earlier time.
- Although it remains for the plaintiffs to establish both the materiality of the information and a breach of the company's obligations to disclose under section 674(2) and Listing Rule 3.1, from a practical perspective it is left for the defendant to establish, based on subjective and statistical evidence, that the information was not material or that exceptions to the disclosure requirements applied.

[6] Although ASIC does have the power to commence representative proceedings under the Corporations Act.
[7] Parallel allegations are also made on the basis of misleading and deceptive conduct.

- All SHCAs commenced in Australia have to date been settled, discontinued or withdrawn prior to judgment. Accordingly, there remains limited judicial guidance as to the application of the continuous disclosure requirements in SHCAs brought on the above basis.

1.3 Observations

By way of summary, the key changes to the context in which the continuous disclosure regime operates since 1994 have been as follows.

Increased statutory backing and increased role of ASIC

- Introduction of civil penalty provision for disclosing entities and those involved in a contravention.
- Introduction of strict liability for disclosing entities and those involved in a contravention for the purposes of civil liability (compensation and civil penalty).
- An infringement notice regime.

Listing Rule changes

- Ability of ASX to apply a false market test.
- Ability of ASX to say information is not confidential.

Class actions

- Significant class action exposure for disclosing entities and those allegedly involved in a contravention.

ASX published its first Guidance Note on continuous disclosure in December 1994, in which ASX said:

> "It is important to bear in mind that Listing Rule 3A(1) expresses broad principles and must be complied with in the spirit of continuous disclosure. It should not be interpreted in a restrictive or legalistic fashion. Only if continuous disclosure is carried out in the spirit of the Rule will the credibility of the market be truly enhanced. The Foreword to the Listing Rules convey this. In Fire and All Risks Insurance Company Ltd v Pioneer Concrete Services Ltd Young J said:
>
> > *one falls into error if one treats the requirements of the Listing Rules as a technical document for construction in the same way as a statute. To my mind the listing requirements are a flexible set of guidelines for commercial people to be policed by commercial*

people. (1986) 10 ACLR 760 at 764, noted on appeal 10 ACLR 801 at 806."[8]

The current Guidance Notes says:

"11. Listing rule 3.1 expresses broad principles that cannot be defined with absolute clarity. The rule must be complied with in the 'spirit' of continuous disclosure. Listing rule 19.2 makes it clear that the Listing Rules should not be interpreted in a restrictive or legalistic fashion. Listing rule 19.2 states:

An entity must comply with the Listing Rules as interpreted:

- *in accordance with their spirit, intention and purpose;*
- *by looking beyond form to substance; and*
- *in a way that best promotes the principles on which the Listing Rules are based.*

12. The integrity of the market is enhanced if continuous disclosure is carried out in the 'spirit' of the Listing Rule. The principles on which the Listing Rules are based encompass the interests of listed entities, maintenance of investor protection and the need to protect the reputation of the market."

While ASX has retained the concept of interpretation in accordance with the "spirit" of the Listing Rules, notably it no longer talks about "a flexible set of guidelines for commercial people to be policed by commercial people". Arguably, having regard to the statutory backing that was introduced in 1994, this was no longer the case even when the original Guidance Note was published. It is certainly no longer the case today.

One aspect of this is the greater role of ASIC:

> As the learned authors of Ford's Principles of Corporations Law point out, Parliament has progressively reversed the original policy under which primary responsibility for enforcing the continuous disclosure requirements of the Listing Rules fell on the ASX. Clearly, ASIC now has the pre-eminent role in the enforcement process. Indeed, the Explanatory Memorandum to the 2004 Act stresses ASIC's primary and direct responsibility for monitoring and enforcing the continuous disclosure provisions.[9]

In this context, it is noted that ASIC has an obligation to take whatever action it can take, and is necessary, in order to enforce and give effect to Corporations Act.[10]

[8] Guidance Note, Listing Rule 3A(1), December 1994, p94/4.
[9] Young, NJ, "ASX Disclosure and Misleading Conduct", Banco Court, Supreme Court of Victoria, 15 August 2011.
[10] Australian Securities and Investments Commission Act 2001, section 1(2)(d).

The other aspect is the greater role of private enforcement ie through class actions.

Accordingly, while before the introduction of statutory backing there was a degree of flexibility in the enforcement of the Listing Rule available to ASX, and ASX was able to take a commercial approach, the Rule now needs to be assessed in the current context, where it is enforced by ASIC through the Corporations Act and by class action promoters. In this context, a greater degree of rigour is justified in making sure that the Listing Rule is expressed as it is intended to operate.

As well as these developments, there are 17 years of market experience in the operation of the current form of Listing Rule 3.1.

2. Changes that can be effected through Guidance Note change or change in ASX practice

As noted above, in some cases the following proposals identify changes to the Listing Rule as desirable, but they are included here as they could also be implemented to some extent through changes to the Guidance Note (possibly followed by a later Listing Rule amendment).

2.1 Requirement for "immediate" disclosure

2.1.1 History

Various views have been expressed about the timing for disclosure. In the CAMAC Report in 1991, "Report on an Enhanced Statutory Disclosure System", CAMAC recommended statutory continuous disclosure as follows:

> "8. An optional two-step disclosure system is proposed. Upon directors of a disclosing entity becoming aware of a "material matter", they should, as soon as it is practicable and in any event with 24 hours, either:
>
> (a) lodge a completed Statement of Material Mater with ASC; or
>
> (b) issue, and lodge with the ASC, a press release outlining the material matter.
>
> If directors choose option (b) they must subsequently lodge the Statement of Material Matter with the ASC within 2 business days of the initial press release."

CAMAC went on to explain the rationale for this, compared with "immediate" disclosure under the Listing Rules:

> "The Committee takes the view that a requirement for "immediate" disclosure of all material matters could promote the release of unreliable information or place too onerous a task upon management".[11]

This was followed by the Commonwealth Attorney-General releasing issues papers, in August 1992, including "Nature of Continuous Disclosure Obligations and Liabilities" in which the proposal was for disclosure "within as short a period as practicable but any event within 3 business days after the occurrence of a significant change affecting the financial position and prospects of a disclosing entity".[12]

[11] At page 23.
[12] At para 1

The *Corporate Law Reform Bill (No 2) 1992* adopted this approach, requiring disclosure "as soon as practicable, and in any event within 3 business days, after the happening of the notifiable event" (clause 1084C(3)).

Accordingly, when it was intended that there should be a statutory continuous disclosure system, the obligation to disclose "immediately" was not imposed; the obligation was to disclose "as soon as practicable", with an outer limit. The concept of "as soon as practicable" has been adopted in the Corporations Act for the disclosure obligation for an unlisted disclosing entity (section 675(2)). In the context of listed entities, the requirement for "immediate" disclosure is through the Listing Rule. As discussed above, the context for the obligation in the Listing Rule has significantly altered with increased "statutory backing", as well as the threat of class actions.

2.1.2 Commentators

In 1994, Koeck said:

> "Obviously, "immediacy" is more in the nature of an aspirational requirement, rather than one that can be read too strictly".[13]

Koeck noted that the unlisted disclosing entity provisions refer to as soon as practicable. He notes that the terms take their meaning from the context. While it may be argued that immediately has a meaning more akin to as soon as practicable in this context, it is doubtful whether such a liberal interpretation will be accepted by a court.[14] More recently, Bloch et al suggest:

> "It may also now be time for a detailed review of the practical operation of the continuous disclosure regime. In the current authors' view, it would be appropriate to amend the form of Listing Rule 3.1 to replace the term "immediately" with the word "promptly" (or other similar expression), or, at the very least, to amend ASX Guidance Note 8 to provide further guidance on this issue. *[Footnote: Others may prefer the expression "as soon as practicable" for consistency with the disclosure timing requirement for unlisted entities in s 675(2) of the Corporations Act 2001 (Cth). The current authors prefer the term "promptly" as it suggest a stricter timing requirement for listed entities.*] This would address the problem identified

[13] Koeck, WJ, "Continuous disclosure", (1995) 13 C&SLR 485.

[14] At page 503. Before making this observation Koeck refers to two cases which suggest that "immediate" has a meaning akin to "as soon as practicable". Other cases, such as *Measures v McFadyen* (1910) 11 CLR 723 also suggest a meaning of "as soon as reasonably practicable in the circumstances, taking into account the nature of the act to be done". However, as observed by Koeck in the context of the Listing Rules this may not be the interpretation taken. The submission is that if this is the interpretation meant, then these words should be used instead.

by Austin [*Footnote: The provision self-evidently cannot be read to require instantaneous, mechanical transmission of information..."immediately" must [therefore] encompass a reasonable period for decision-making."*]..., and also by Koeck and Ramsay, who have argued:

> "The core problem is that an obligation to immediately disclose material matters is an aspirational requirement. There are reasonable grounds for believing it is not possible for all disclosing entities and honest, well-meaning, appropriately qualified executives to ensure compliance all the time."[15]

2.1.3 ASIC

The view of the regulator also needs to be considered and it would appear that ASIC takes a strict interpretation in relation to timing. In a recent Centre for Corporate Law and Securities Regulation, Melbourne Law School research paper,[16] the authors observe that in the context of infringement notices there have been three instances where the period of non-disclosure alleged by ASIC is under 24 hours:

- Promina Group (2006) – failing to inform ASX of receiving proposal to acquire all the ordinary shares of the company (takeover negotiations) – approximately 20.5 hours (during which time the market was open for approximately 3 ½ hours).
- Rio Tinto Limited (2007) – failing to immediately notify ASX of no longer confidential information about its acquisition of Alcan – approximately 1 hour 12 minutes.
- Commonwealth Bank of Australia (2008) – failing to notify ASX of negative price-sensitive information re significant deterioration in its expected LIE ratio (expected loan impairment expense (LIE) to gross loans and acceptances ratio of the financial year ending 30 June 2009) - approximately 4 hours 10 minutes (during which time the market was open for approximately ¾ hour).

The authors observe:

> "...the contexts identified above suggest possible areas in which it may be more difficult for a disclosing entity to satisfy its continuous disclosure obligations to the standards expected of ASIC. That is, it may be more

[15] At pages 260-262.
[16] Desai, A and Ramsay, I M, "The use of infringement notices by ASIC for alleged continuous disclosure contraventions: Trends and analysis", 2011.

challenging for companies involved in takeovers, mergers, drug trials or the Materials sector in general (for instance), to maintain continuous compliance to the required standards. This raises the more fundamental question of just how long companies should have to disclose relevant information, particularly as it appears so heavily dependent upon the prevailing context...

...

The current standard for listed entities, operating through ASX Listing Rule 3.1, requires a disclosing entity to "immediately" disclose such information to the market. The question is whether a more flexible standard is preferable when it comes to these minor contraventions, such that disclosure should be made 'as soon as practicable' in order to account for the specific context. A further research issue is whether a more flexible disclosure standards, as well as greater instruction for the regulator regarding these contextual considerations, may benefit disclosing entities...as well as the transparency and consistency of the regime's application."[17]

2.1.4 Directors

Directors have also expressed concerns about the "immediate" obligation. The top 5 compliance issues identified in a recent survey by a national law firm included continuous disclosure compliance.[18]

> "There was overwhelming support from survey respondents for a modification to ASX Listing Rule 3.1 to require that information be disclosed "as soon as practicable" rather than "immediately". 64% of survey respondents either agreed or strongly agreed that such a change would be in the best interests of the market, with only 22% not favouring the change (14% had no opinion). These results reflect a view that investors will receive disclosure which is more accurate and less likely to be misleading in circumstances where companies have had the benefit of some additional time to properly assess the information and to prepare a considered and appropriately worded ASX release. The current wording of ASX Listing Rule 3.1 and its history of enforcement are such that it would be desirable to give directors and senior management more time to form an appropriate judgment on matters which will, or may, require disclosure.

[17] At pages 21 and 34.
[18] Mallesons, "Directions 2011: Current issues and challenges facing Australian directors and boards", 2011.

…

Hurried or premature disclosure may in fact be less desirable in circumstances where market certainty is the aim."

2.1.5 Observations

Accordingly, there is a lack of clarity as to what is meant by "immediate" and, depending on the meaning, there is an issue of whether it is possible to comply. The obligation to disclose arises when the entity becomes "aware" of the information. An entity is "aware" of information when "a director or executive officer...has, or ought reasonably to have, come into possession of the information in the course of their performance of their duties as a director or officer" (Listing Rule 19.12).

Prudent companies will have processes in place for compliance and to make sure that there is decision-making at an appropriate level before an announcement is made. An executive officer, such as the chief financial officer, personally may be convinced an announcement is required, but after board discussion, there is a different view. Bloch et al argue that a strict approach is required in the case of selective disclosure, but it is more difficult to calibrate in the context of earnings guidance, which can be a lengthy and complex task with information gathered from a number of sources, and assumptions made about future events which require review by senior executives and in some cases the board.[19]

The observations by commentators, including academics, demonstrate that there is uncertainty about the meaning of "immediate" and the infringement notices issued by ASIC mentioned above suggest that ASIC's interpretation allows very limited time for a disclosure decision. As noted in the CAMAC report, one concern is that an "immediate" obligation may lead to unreliable disclosure. For completeness, it is noted that trading halts can assist in managing this issue – see further below (para 2.2).

In addition, having regard to the current statutory regime and threat of class actions it is unreasonable for entities and directors to be exposed to legal actions where the obligation is at best uncertain and at worst not possible to comply with.

2.1.6 Recommendation

Accordingly, we recommend that ASX give consideration to amending the Listing Rule, to require disclosure "as soon as practicable" or "promptly". This could also incorporate an outer time limit (eg a set number of business days, or 24 hours as

[19] At page 261.

originally proposed by CAMAC). In the absence of a Listing Rule amendment, it is recommended that ASX amend the Guidance Note to make it clear that this is the meaning of "immediate" in the context of continuous disclosure (relying on the interpretation provision in Listing Rule 19.2), and that entities may go through prudent decision-making processes before making an announcement. The Guidance Note could state that the release of information must be consistent with the duty to make sure that the information is accurate. ASX could indicate that it has a flexible understanding of the term "immediate" which enables the term to encompass a wide range of circumstances that might affect the time within which information must be released.

2.2 The impact of a trading halt on disclosure obligations

2.2.1 Background

Guidance Note 8 presently contemplates the use of trading halts as a tool of good disclosure.

Where a leak appears to have occurred or there are unexplained movements in trading price or volume, but a company is not yet in a position to make specific disclosure, and any preliminary disclosure it might make would not be sufficient to inform the market properly or may mislead the market (for example in the case of incomplete merger negotiations), an appropriate way of dealing with continuous disclosure obligations would be to seek a trading halt, with the request for the halt (for public release) merely including a statement that confidentiality may have been lost in negotiations or similar.

This approach, and the fact that it reflects the principle that the Listing Rules are required to be interpreted in accordance with their 'spirit, intention and purpose'[20], is also reflected in Guidance Note 16:

> 'Both trading halts and voluntary suspensions are important measures that entities can use to manage their continuous disclosure obligations so as to comply with the letter and spirit of Listing Rules 3.1, 3.1A and 3.1B. The purpose and effect of those Listing Rules is to ensure that information that a reasonable person would expect to have a material effect on the price or value of an entity's securities is released to the market in a timely manner, so that trading in those securities can take place on a reasonably informed basis. Compliance with this obligation is central to ensuring that trading in

[20] Listing Rule 19.2.

ASX quoted securities takes place, to the extent it reasonably can, in a fair, orderly and transparent manner.'

We submit this is sensible approach.

2.2.2 Application

However, it is not clear whether it accords with ASIC's position. Some (but not all) of ASIC's statements and actions in this area appear based on the premise that continuous disclosure obligations under Listing Rule 3.1 and section 674 of the Corporations Act are unaffected by whether or not a stock is in trading halt (or for that matter whether or not the market is closed). That position would be technically correct at law if the Listing Rules were not required to be interpreted in accordance with their 'spirit, intention and purpose', but is not correct given that they are required to be so interpreted.

The infringement notice served on Commonwealth Bank of Australia (CBA) in relation to the disclosure of loan impairment expenses of 16 December 2008 related to a period from 'about 3.00pm', when ASIC considered CBA became aware of the information until 7.10pm when it was announced to ASX, despite normal trading finishing at 4.00pm and the single price closing auction finishing no later than 4.12pm and despite a draft announcement in relation to the matter only becoming available at 3.59pm.[21]

The draft regulatory guide released in December 2009 as part of ASIC Consultation Paper 128 'Handling Confidential Information' included the following:

> "A company must comply with its continuous disclosure obligations even if the quotation of the company's shares is suspended or subject to a trading halt (see Listing Rule 18.6). Companies and their directors should be cognisant that trading can occur on markets other than ASX and through over-the-counter (OTC) markets (such as the CFD markets), and the trading halt will not extend to those markets. Companies should also recognise the fact that a transaction in its securities may affect the trading of the company's peers and competitors."[22]

On the other hand, the infringement notice served on Rio in July 2007 in relation to the Alcan bid related to a period between a Dow Jones article appearing and the company going into trading halt (without any preliminary announcement at all), and not to when the deal was announced later that day.

[21] Which of course underlines the importance of the 'immediate' / 'as soon as practicable' issues addressed above (para 2.1)
[22] At para 28.

Also, the 2009 draft regulatory guide referred to above is unlikely to become a final regulatory guide, and may in fact have been modified (had it been issued) in relation to this point.

It is submitted that the correct approach should be to acknowledge that during a trading halt, there is greater practical latitude in the making and timing of disclosure.

2.2.3 Recommendation

ASX can address this issue in the revised Guidance Note 8 by more explicitly acknowledging that greater latitude in making disclosure and the timing of disclosure is permitted where a listed entity is in trading halt.

As noted, the Listing Rules are to be interpreted in accordance with their spirit, intention and purpose, by looking beyond form to substance, and in a way that best promotes the principles on which the Listing Rules are based. The relevant stated principle is that timely disclosure must be made of information which may affect security values or influence investment decisions, and information in which security holders, investors and ASX have a legitimate interest. However, while trading is halted, investment decisions are not being made on ASX's market, and an overt signal is available (in respect of any off-market trading) that the market may not be fully informed, and moreover, a trading halt enables companies to frame meaningful disclosure rather than being forced to preliminary incomplete disclosure which may mislead, or in any case not properly inform, the market.

2.3 A reasonable person would expect information to have a material effect on the price or value of securities

2.3.1 Background

The continuous disclosure obligations under Listing Rule 3.1 apply to information concerning an entity that a *"reasonable person would expect to have a material effect on the price or value of the entity's securities*". Information will have this effect 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 securities"* (section 677).

Guidance Note 8 is largely silent on how an entity should assess whether information would have a "material effect", other than to note that a variation in excess of 10% - 15% of an entity's previously released financial forecast or

expectation may generally be considered material and should be announced by the entity.[23]

We discuss the issues with the test in more detail in section 3. Acknowledging the observation by ASX that to change the Listing Rule would create a mismatch with section 677 of the Corporations Act, we have restricted our observations in this section to clarification in the Guidance Note.

2.3.2 Recommendation

- We suggest that the current test of whether information would have the relevant material effect (ie if that information would "influence persons who commonly invest in securities in deciding whether to acquire or dispose of the securities"), is unclear and may be interpreted to impose too low a threshold.
- In addition to the existing ASX guidance of 10% - 15% for profit variations (which we believe is useful and should be retained), we recommend introducing an objective measure in Guidance Note 8 to assist companies in assessing materiality, by reference to the likely effect on an entity's share price or value. We suggest that a movement of 5% or more in an entity's share price or value would be a reasonable threshold by which to assess materiality.
- We recommend that Guidance Note 8 clarify that, if particular information would result in a movement of 5% or more of an entity's share price or value, ASX would consider such information to be information that:
  - would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the securities; and
  - a reasonable person would expect to have a material effect on the price or value of the entity's securities.

2.4 When an obligation arises to correct material information

2.4.1 Background

The question of whether the continuous disclosure laws require an entity to correct an earlier inaccurate announcement was considered by the Full Federal Court in *Fortescue Metal Group Limited & Anor*.[24] Fortescue had made incorrect ASX announcements to the effect that it had entered into "binding" agreements with various Chinese contractors to build, finance and transfer infrastructure. On their true construction, the agreements were held to be agreements to agree.

[23] Guidance Note 8, at para 93.
[24] [2011] FCAFC 19.

The Full Federal Court acknowledged that section 674 does not in its terms require correction of an incorrect statement. (The failure to correct such a statement can, of course, have ongoing implications under the misleading and deceptive conduct laws). However, the Full Federal Court found that in this instance Fortescue had breached its disclosure obligations by failing to correct the earlier announcements.

The Court's reasoning in this aspect of the decision is not entirely clear. Some parts of the judgment suggest that the circumstance that Fortescue had misled the market with its earlier announcements was sufficient to oblige Fortescue to make an announcement under its continuous disclosure obligations as to the true position. For example, the Court says "the circumstance that FMG's management had mis-stated the terms of the agreements was a circumstance necessarily apt to affect the confidence of investors in the management of the enterprise – and hence influence them to acquire or dispose of FMG shares over and above the influence which the [original] information actually disclosed by FMG may have had."[25]

On the other hand, the Court appears to recognise the materiality of the correct information when it says "In the state of affairs brought about by FMG's misleading statements, there can be no room for any suggestion that the corrective information which FMG was obliged to provide was not material within the meaning of s 677 of the Act."[26]

Uncertainty as to whether the Court's decision was based on the misleading nature of the earlier announcement, or the materiality of the correct information, is causing concern.

Special leave to appeal the decision was recently granted by the High Court to the defendants (Fortescue and Mr Forrest). A hearing is not expected before 2012.

2.4.2 Recommendation

We acknowledge that the continuous disclosure laws may require disclosure of the correct position where there has been a previous misleading announcement. However, this should only be where disclosure of the correct information would be price sensitive to an entity's securities in a market which has already factored in the misleading and deceptive information.

This involves considering the impact the correct information would have on the market as it exists at that time (including considering whether the previous incorrect announcement has any ongoing effect). It should not be necessary

[25] At para 183. See also paras 184 and 189.
[26] At para 189.

under the continuous disclosure laws for entities to monitor previous announcements or make a further announcement whenever an earlier inaccuracy is discovered – the materiality of the information at the time the inaccuracy is discovered should be the criterion. To require otherwise would not be in the interests of shareholders, and would not advance the interests of investors or the market in any helpful way.

Amending Guidance Note 8 to focus on an objective test for materiality would be helpful in this regard. However we suggest that, if the recommendation in para 2.3.2 above is adopted, the amended Guidance Note should go on to state that the same principle (ie 5% movement) applies in relation to corrective information. Such a change would not circumvent any decision which the High Court might reach in the Fortescue case, but it would provide useful guidance as to ASX's views.

2.5 How to deal with the expression of an opinion

2.5.1 Background

Guidance Note 8 currently contemplates that information which is disclosed by companies to the market "*should be in a form that is suitable for release*". We recommend that for the reasons outlined below, the Guidance Note be updated to provide companies with further guidance on the form and manner in which they should disclose factual information to the market, as compared to the form and manner in which they should disclose information which is opinion based. We consider that ASX should give more direction to companies on how they should distinguish between these two types of statements in a market release.

The Federal Court decision of *Australian Securities and Investments Commission v Fortescue Metals Group Ltd and Another,*[27] demonstrates the difficulty an investor may face in distinguishing between factual information and that which is opinion based in a market release if ASX announcement is not clear on this point.

In that case, the trial judge commented that statements made to the effect that Fortescue Metals Group had executed binding build and transfer agreements with each of the Chinese Contractors, may be thought to be characterised as statements of fact rather than opinion as they were "assertive in nature and were not expressly said to be expressions of opinion". Despite this, the trial judge found that in this case an assertion as to the meaning and legal effect of an agreement was "necessarily the product of an opinion formulated to that effect". On this

[27] [2011] FCAFC 19.

basis, the trial judge found that there was no breach of the continuous disclosure obligations by Fortescue Metals Group.

On appeal, the Full Federal Court came to a different conclusion, finding that there was in fact a breach of the continuous disclosure obligations by Fortescue Metals Group. The Court found that the trial judge erred in failing to conclude that Fortescue Metals Group's public statements would have been understood as statements of fact by ordinary and reasonable members of the investing public. The Court found that a statement by a company to ASX about the effect of an agreement will not be understood by investors as merely conveying an opinion by the directors or company, unless it is clearly expressed as such.

The Federal Court also commented that focus must be upon the effect or likely effect of the statements, in the circumstances in which they were made, on the minds of ordinary and reasonable members of the class of persons, such as investors, to whom it was addressed. The Federal Court found that it is the effect of a statement upon the persons to whom it is published, rather than the mental state of the publisher, which determines whether the statement is misleading or deceptive, or likely to mislead or deceive. Ultimately, the court found that the real question is whether the statement is, in the circumstances of the case, apt to mislead those to whom it is published.

2.5.2 Recommendation

Accordingly, consistent with the themes in this Federal Court decision (currently on appeal), we recommend that the Guidance Note clearly specify that:

- if a company is required to make statements to ASX and investors about entry into an agreement, a company can do so by accurately summarising the effect of the agreement or its relevant material terms, and, confidentiality obligations permitting, it is always open to the entity to publish a copy of the relevant agreement;
- where information or statements in a market release are not objectively verifiable, they may *not* be seen to be more than an opinion; and
- if a company is conveying an opinion by its directors or the company in a market release, it should clearly express it as such.

2.6 How to deal with a variation from analyst consensus forecasts

2.6.1 Background

We think that it would be beneficial to provide further guidance in Guidance Note 8 in situations where companies may be required to make disclosure if analysts' consensus forecasts differ materially from internal forecasts.

Guidance Note 8 states:

> "In some cases it may be appropriate for a listed entity to disclose material variations from analysts' consensus forecasts and expectations. This may occur where previous results do not provide the most relevant reference point or the market is moving in such a way as to indicate that there is a false market in the entity's securities."[28] (emphasis added)

On 22 January 2009 and 11 January 2010, ASX released companies' updates which stated:

> "Entities are required to make an appropriate announcement immediately they become aware that there is expected to be a material difference in the financial results for that period from the results that were recorded in the previous corresponding period, or from forecasts for that period that have been provided to the market by the entity, or (in some cases) from analysts' consensus forecasts." (emphasis added)

The 24 January 2011 version omits the "(in some cases)" qualification.

We note that the companies updates go further than the reference to disclosure being "appropriate", as set out in Guidance Note 8. However, no working examples have been provided as to when disclosure will actually be required.

2.6.2 Recommendation

We recommend that Guidance Note 8 be amended to clarify ASX's expectations in this area, and also to include working examples on when material variations from analyst consensus' forecasts "require" disclosure.

We add that the preparation of an earnings forecast can be a lengthy and complex task, requiring information to be gathered from a number of sources within the disclosing entity. Gill North also points out that disclosure between reporting periods is only useful to investors when it is "understandable, complete, and in an appropriate form that allows it to be readily connected to, and compared with information provided in periodic reports".[29]

We recommend that Guidance Note 8 be expanded to state that a company is only required to make disclosure of material variations once internal forecasts have

[28] At para 95.

[29] Gill North, "Continuous disclosure in Australia: The empirical uncertainties", (2011) 29 C&SLJ 394, at pages 417-418.

been properly verified and are in the final form approved (if the entity so decides) by its Board. This should be the appropriate time for disclosure rather than some earlier time at which "a director or executive officer … has, or ought reasonably to have, come into possession of the information in the course of performance of their duties …".[30]

2.7 How the reasonable person test operates

2.7.2 Background

The first limb of the exception in Listing Rule 3.1A is that a reasonable person would not expect the information to be disclosed.

From Guidance Note 8:

> "... A reasonable person would not expect information to be disclosed if the result would be unreasonably prejudicial to the entity.
>
> If Listing Rules 3.1A.2 and 3.1A.3 are satisfied but a reasonable person would expect the information to be disclosed (for example, where there is a material variation in financial results from the previous corresponding period or previous announcements), the exception is not available and the entity must disclose the information.
>
> ASX will balance the needs of the market and the interests of the entity, bearing in mind the principle on which the Listing Rule is based, when considering if this requirement is satisfied. The use of the word 'reasonable' indicates an objective test. However, as market practices and expectations evolve what is considered reasonable will also change."

The original intent of this limb of the exception is likely to have been a final constraint on unreasonable behavior by a listed entity, where the company meets one of the carve outs in Listing Rule 3.1A.3, the information is confidential, but prevailing views are that the information should not be withheld. An example might be the material variation in financial results mentioned in the above quote from Guidance Note 8.

The operation of the first limb of the exception is unclear.

We are concerned that this limb of the exception may be treated as a rebuttable presumption, with the starting point that a reasonable person requires disclosure, and the onus resting on the company to persuade ASIC or a court that disclosure was not required.

[30] ASX Guidance Note 8.

As noted above (para 1.2.4), we are also concerned that SHCAs are commonly commenced on the strength of limited publicly available information including disclosures made by the listed entity and evidence regarding the reaction of the market to such disclosures. Although it ought to remain for the plaintiff to establish both the materiality of the information and a breach of the company's obligations to disclose earlier, from a practical perspective it is left for the defendant to establish, based on subjective and statistical evidence, that exceptions to the disclosure requirements apply.

2.7.3 Recommendation

We recommend that ASX consider either removing this limb of Listing Rule 3.1A, or at least stating in its Guidance Note that the exception from disclosure will only rarely be lost in situations where the other limbs are satisfied because of a failure to satisfy the reasonable person test, as well as including examples of the operation of the limb.

2.8 Price query letter

2.8.1 Background

We note that ASX may issue a standard price query letter to a listed entity when it considers that there has been a material increase or decrease in the entity's share price over a short period (usually 1-3 trading days), which is not explicable by reference to an announcement on the entity's ASX platform. While we understand that there is no fixed "rule of thumb", and that it can depend on the entity's market capitalisation and the liquidity of trading in the entity, a 7% movement in a day or a 10% movement over 2-3 days may be considered material.

The obligation to respond to such queries arises from Listing Rule 18.7, which requires an entity to "give ASX any information, document or explanation that ASX asks for to enable it to be satisfied that the entity is, and has been, complying with the Listing Rules". We note that the response is only required to be given to ASX itself, and the entity is not required to make an ASX announcement in respect of the response. The ASX has a discretion whether to publish the price query letter and response if it has reserved the right to do so (which it does in the standard letter) "and considers that it is necessary for an informed market" (Listing Rule 18.7A). We expect (and in our experience, listed entities assume) that in practice the large majority of price query letters and responses are published.

2.8.2 Assertion of loss of confidentiality

ASX's standard price query letter includes the following paragraph:

> "Please note that as recent trading in the [entity's] securities could indicate that information has ceased to be confidential, the [entity] is unable to rely on the exceptions to Listing Rule 3.1 contained in Listing Rule 3.1A when answering this question."

We note that the standard price query letter usually does not state or suggest that ASX:

- has formed the view that particular information has ceased to be confidential (Listing Rule 3.1A.2); or
- considers that there is, or is likely to be, a false market in the entity's securities, in which case the entity must give ASX the information necessary to correct or prevent the false market (Listing Rule 3.1B).

In either of those cases, ASX has specific authority to override the carve-out to continuous disclosure in Listing Rule 3.1A, although it would need to have some basis to form such a view (such as a reasonably specific rumour or media comment).

Accordingly, given that ASX has these specific powers to override the continuous disclosures carve out where it has a reasonable basis to do so, and that the powers in Listing Rule 18.7 relate to determining whether an entity is complying with the Listing Rules (including as qualified by the Listing Rule 3.1A carve-out), we do not think it is appropriate for ASX to use Listing Rule 18.7 to impose a blanket removal of the continuous disclosure carve out, and effectively require the entity to put out urgently a complete "cleansing statement" in relation to itself.

In particular, unusual price movements do not necessarily indicate a loss of confidentiality about particular information (such as an incomplete proposal), as the movements may be attributable to other factors (such as external industry or market factors), or they may not be explicable by the entity. By way of example, entities often work on multiple incomplete proposals at any one time, and there may potentially be a loss of confidentiality on some of the information, but not necessarily a loss of confidentiality on all of the information which would fall within the carve out in Listing Rule 3.1A. Should ASX effectively force disclosure of all carve out information, potential corporate dealings may be jeopardised, in such a way that the proposed transaction may not proceed, or may only proceed on terms less favourable to the entity than would have been the case had the entity not been forced to disclose prematurely what it considers to be confidential carve out information.

A note to Listing Rule 18.7A states that "if an entity believes that information it gives ASX comes within the exception to Listing Rule 3.1 in Listing Rule 3.1A, the entity should raise this issue with ASX at the time the information is given to ASX". First, this contemplates that entities should continue to have the benefit of the carve out in connection with Listing Rule 18.7 correspondence, and there is nothing in Guidance Note 8 which suggests otherwise. This is also consistent with the purpose of Listing Rule 18.7, which is to enable ASX to determine compliance with the Listing Rules. Second, given the short timeframe in which responses are required to be provided, in practice it is difficult for entities to have a meaningful dialogue with ASX as to whether certain matters are required to be disclosed. In practice it appears to be more of an automatic and general "whitewash" procedure, with little opportunity to discuss and agree with ASX whether particular information continues to be exempt from disclosure.

2.8.3 Recommendation

In view of the above, we recommend that the relevant paragraph in the standard price query letter be amended as follows:

> Please note that recent trading in the [entity's] securities could indicate that information has ceased to be confidential. *If so,* the [entity] is unable to rely on the exceptions to Listing Rule 3.1 contained in Listing Rule 3.1A *in respect of that information* when answering this question. [Proposed amendments indicated in italics]

We also recommend that:

- the market should be provided with further guidance as to the triggers and process after which ASX issues price queries, and how entities can comply with price queries while continuing to protect information being validly withheld under the carve-out in Listing Rule 3.1A;
- there should be a commitment by ASX to consult with the entity, where practicable, before the price query is issued in respect of whether any particular information may have ceased to be confidential, and in respect of whether it is necessary for any price query correspondence to be published; and
- there could also be market consultation and further guidance on the circumstances in which price query correspondence will not be required to be published (eg such as where the correspondence does not result in any new material disclosure or has been overtaken by other events).

This would involve further guidance in Guidance Note 8 and updating the commentary beneath Listing Rule 18.7A.

If ASIC and ASX are seeking to improve and encourage full and frank disclosure to ASX listings advisers in the price query process[31], they should demonstrate that ASX will not require blanket disclosure in appropriate cases.

3. Changes that would require substantive Listing Rule or Corporations Act amendment

3.1 Introduction

As discussed in the introduction to this submission, in section 2 we identified changes that could be effected through a Guidance Note change or change in ASX practice, but in some cases a Listing Rule or Corporations Act change would be a preferable long-term solution. The rationale is set out in section 2, but by way of summary those issues are as follows:

- Requirement for "immediate" disclosure – see section 2.2.
- A reasonable person would expect information to have a material effect on the price or value of securities – see sections 2.3 and 2.4, and the further submission below in section 3.2.
- How the reasonable person test operates – see section 2.7.

In addition, we have raised a proposal to provide protection for an honest judgement call – see section 3.3 below.

3.2 A reasonable person would expect information to have a material effect on the price or value of securities

3.2.1 Background

The background to this issue is discussed above – see section 2.3.

3.2.2 What is the current test of materiality?

The continuous disclosure obligations under Listing Rule 3.1 apply to information concerning an entity that a *"reasonable person would expect to have a material effect on the price or value of the entity's securities*". This definition tracks the wording used in section 674 of the Corporations Act, which gives statutory backing to Listing Rule 3.1. For the purposes of this submission, we refer to this as the "material effect test".

Information will have the relevant effect under section 674 if the information would, or would be likely to, "*influence persons who commonly invest in securities in*

[31] See, for example, ASIC's market assessment report: ASX Group No. 265 dated November 2011, paras 69-72.

deciding whether to acquire or dispose of the securities" (section 677). For the purposes of this submission, we refer to this as the "influence test".

Guidance Note 8 is largely silent on how an entity should assess whether information would have a "material effect on price or value", other than to note that a variation in excess of 10% - 15% of an entity's previously released financial forecast or expectation may generally be considered material and should be announced by the entity.[32]

However, the "influence test" in section 677 is imported by the Listing Rules and has been applied by the courts for the purposes of determining the operation of Listing Rule 3.1.[33] Under this test, as applied by the court in *Jubilee Mines NL*, any information which would or would be likely to influence an investment decision in accordance with section 677 is automatically deemed to have a "material effect" on the price/value of securities. However, the ambit of that test is not clear.

No consideration is given to the extent of that influence on an entity's share price or the likely magnitude of any associated share price movement. Additionally, whether the persons who usually invest in securities would be acting reasonably in being influenced by particular information would also appear to be irrelevant to the application of the test.

The definitions in sections 674 and 677 are substantively similar to (and indeed were based on) the definitions used in the insider trading provisions of the Corporations Act (see sections 1042A and 1042D). For the reasons set out more fully below, we question whether identical tests are appropriate.

3.2.3 Why is an objective measure required?

While it should not be the case in principle, as a matter of practice, regulatory proceedings on continuous disclosure breaches are judged with the benefit of hindsight (and years of judicial decisions) and with the assistance of market experts to determine whether or not the undisclosed information would have had a "material effect" on price or value.

Companies, on the other hand, are expected to make disclosure decisions "immediately" and with very limited objective guidance. The application of the "influence test" to determine if disclosure is required is particularly unhelpful, as the test may not have a high threshold, contains no inherent materiality qualifiers and is ambiguous and confusing.

[32] Guidance Note 8, at para 93. Paragraph 94 goes on to note: "Similarly, a larger variation may not necessarily be disclosable provided it is not material" and sets out guidance on such disclosure.
[33] Listing rule 19.3 and *Jubilee Mines NL v Riley* (2009) 69 ACSR 659; 226 FLR 201; 27 ACLC 164; [2009] WASCA 62.

We suggest that it would be in the interests of the market to have more specific measures against which companies can more readily determine whether or not they are required to disclose particular information. In Guidance Note 8 ASX recognises that some measure of specificity is appropriate in relation to profit variations (being 10% - 15%), but this guidance does not go far enough.

(a) The "influence test" is too ambiguous and may be interpreted to impose too low a threshold

The application of the "influence test" to the Listing Rules is unhelpful for market participants as it contains no clear and explicit materiality threshold against which companies can test whether information should be disclosed.

Some commentators and judges have argued that the "influence test" is interlinked with materiality considerations, in that information will only be material if it would or would be likely to "influence" persons who commonly invest. However, the definition of "influence" for the purposes of section 677 is not clear and may not be a high threshold.

In *ASIC v Fortescue Metals Group Ltd [No 5]*[34] Gilmour J held that "the threshold of relevant influence is not ... a high one"[35] and that the question of influence "involves a matter of judgement, informed by commercial common sense and, if necessary, by evidence from persons who have practical experience in buying and selling shares and in the workings of the stock market".[36] Gilmour J's position that the "likely influence" test is not a high threshold was echoed by Keane CJ in the Full Federal Court decision *ASIC v Fortescue Metals Group Ltd.*[37] However, the standard against which the threshold of influence should be measured was not made clear by either Gilmour J or Keene CJ.

Given this lack of clarity, the test creates significant uncertainty for listed entities in determining whether or not particular information should be disclosed, unless they adopt a policy of disclosing essentially "everything, all the time".

It was said in *Jubilee Mines* at first instance that the "influence test" in effect requires companies to ascertain the class of people that would trade in the securities of the company in order to determine if they would be the kind of "common investor" to which the test applies.[38] This further increases the scope for confusion for companies when discharging their continuous disclosure obligations.

[34] [2009] FCA 1586.
[35] At para 482.
[36] At para 511.
[37] (2011) 190 FCR 364; [2011] FCAFC 19 at para 188.
[38] This meant that in the case of a junior mining explorer such as Jubilee, the common investor would be traders after a comparatively quick profit; *Riley v Jubilee Mines NL* (2006) 59 ACSR 252; [2006] WASC 199 at

For example, a blue chip company with a large retail shareholder base might consider "common investors" in its securities to be the general investing public, ie mums and dads. If the circumstances of the company subsequently alter and, say, the company then becomes the subject of a large number of algorithmic trades or a large number of hedge funds join the register, the class of "common investor" might change and the consideration of what might influence that type of common investor would also change. A company would have to turn its mind to who the class of "common investor" in its securities might be each time the composition of its register alters substantially, which may occur relatively frequently depending on the circumstances of the company (eg if the company was the subject of a takeover bid).

Guidance Note 8 provides very limited guidance on how to interpret the "material effect" test (other than the guidance in paragraphs 93 – 95) and no guidance at all on the interpretation of the "influence test".

(b) Information should be assessed by reference to an objective impact on share price/value

Although Listing Rule 3.1 expressly refers to a material effect on the "price or value" of the entity's securities, the "influence test" does not, in its terms, invite a similar inquiry, thus creating further scope for confusion. We suggest that policy would be better served if the continuous disclosure test was clearly applied by reference to the price or value of securities. ASX is a market regulator and offers a market service; the price or value of securities (being a market driven result) is therefore an appropriate measure for a continuous disclosure test.

Keane CJ in *Fortescue* said that the wording of the "influence test" in section 677 does not of itself invite an inquiry as to whether any change in the price of securities has occurred, much less whether a price change was caused by the relevant announcement.[39] While the question of influence may be confirmed or assisted by a demonstrable effect of the particular information on the share price, it is not necessarily a requirement of the test.

As previously noted, the "influence test" has no express materiality threshold in its application. The "influence test" is also arguably likely to be much broader and will capture a much wider range of information than the "material effect" test. As the court in *Jubilee Mines* has noted:

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para 280. This aspect of the master's decision was not challenged on appeal so it was not reconsidered by the Full Court; *Jubilee Mines NL v Riley* (2009) 69 ACSR 659 at para 122.

[39] *ASIC v Fortescue Metals Group Ltd* [2011] FCAFC 19 at para 188.

> *"...it is very difficult to envisage a circumstance in which a reasonable person would expect information to have a material effect on the price or value of securities if the information would not be likely to influence persons who commonly invest in those securities in deciding whether or not to subscribe for, or buy or sell them. The price of securities quoted on a stock exchange is essentially a function of the interplay of the forces of supply and demand. It is therefore difficult to see how a reasonable person could expect information to have a material effect on price, if it was not likely to influence either supply or demand. Rather, on the face of it, the scope of information which would, or would be likely, to influence persons who commonly invest in securities in deciding whether or not to subscribe for, or buy or sell those securities is potentially wider than information which a reasonable person would expect to have a material effect on price or value, because there is no specific requirement of materiality in the former requirement."* [40]

There does not appear to be any substantive policy justification for extending the continuous disclosure requirements beyond information that satisfies the "material effect test" to include information that satisfies the uncertain, and potentially broader, ambit of the "influence test". We suggest that the overlay of the "influence test" is superfluous and only serves to confuse companies and investors (unless the two tests are interpreted in a consistent manner – in which case the "influence test" adds nothing to the "material effect test").

A large amount of information relating to a company is likely to have some influence on investment decisions (if "influence" is – incorrectly from a policy perspective in our submission – given a wide meaning in the sense of "be taken account in reaching" an investment decision). There is no material policy benefit to be gained by requiring companies to continually release such information to the market when there is no real suggestion that such information would materially affect the price of its shares. A number of jurisdictions have a periodic disclosure requirement instead of a "continuous" disclosure requirement. While we do not advocate this, we consider that a disclosure requirement that operates on what might be construed as a "hair trigger" is not conducive to an efficient market.

[40] At para 59.

(c) The continuous disclosure regime should not be used as mechanism to address deficiencies in the insider trading regime

The continuous disclosure tests both in the Listing Rules and the Corporations Act are substantively similar to, and were based on, the insider trading tests in the Corporations Act.

Section 1042A defines "inside information" as information that:

> *"...is not generally available and...if the information were generally available, a reasonable person would expect it to have an effect on the price or value of Division 3 financial products..."*
>
> *Section 1042D goes on state that a reasonable person would be taken to expect information to have a "material effect" on the price or value of financial products:*
>
> *"..if (and only if) the information would, or would be likely to, influence persons who commonly acquire Division 3 financial products in deciding whether or not to acquire or dispose of the....financial products."*

We consider that it is appropriate for the insider trading test to have a lower threshold of materiality (in other words, to capture a broader range of information) than the continuous disclosure test, given the more "insidious" nature of the insider trading offence, which takes advantage of an informational asymmetry and given that continuous disclosure is a market disclosure mechanism, in relation to which companies have to make "immediate" disclosure decisions.

Some symmetry between the continuous disclosure and insider trading tests is logical, as one of the purposes of the continuous disclosure regime is to minimise incidences of insider trading and other market distortions.[41] However, enforcement of the continuous disclosure regime should not be used in place of (and as a proxy for) effective insider trading legislation and the enforcement of that legislation.

It is generally acknowledged that the Australian insider trading legislation suffers from a number of glaring deficiencies[42] and that enforcement can be a complex and uncertain process. In response to this, Australian regulators appear to be using continuous disclosure as a mechanism to drive corporate conduct, by requiring immediate disclosure of a broad range of information so that incidences of insider trading can effectively be reduced.

We suggest that this approach is inappropriate. The Australian investing population would be far better served by rectifying the deficiencies of our insider

[41] *James Hardie Industries NV v ASIC* (2010) 274 ALR 85 at para 355.
[42] Corporations and Markets Advisory Committee, "Insider Trading Report", November 2003.

trading provisions through legislative amendment rather than by exploiting (and possibly undermining) our continuous disclosure regime to tackle these failings.

It may be defensible for insider trading test to operate on a "hair trigger", on the basis that a person in possession of non-public information is able to be (and should be) conservative in their trading decisions, and should not trade if there is any risk if the information they possess is "inside information", either within the "material effect test" or the "influence test". However, the position is different for a listed company determining whether information should be disclosed to the market – the company should not have to disclose all information which might "influence" to some degree (and not necessarily materially) "persons who commonly invest in securities" without a clear materiality threshold. For the insider, the cautious decision is not to trade, which is generally a manageable outcome, but the listed company, the cautious decision becomes almost complete disclosure (subject to the carve-out), which is not a manageable outcome.

3.2.4 Recommendation

We recommend that section 677 of the Corporations Act be amended so that the test is not the "influence test" but simply the "material effect test" (ie as expressed in sections 674 and 675). This could be achieved by deleting section 677, with an appropriate explanation in the explanatory memorandum, in combination with objective guidance from ASX on what would satisfy the "material effect" test (see our recommendations in sections 2.3.3 and 2.4.2). This change would flow through to Listing Rule 3.1, as the Listing Rule adopts the meaning in the Corporations Act if a particular expression in the Listing Rule is not defined.

Failing this, an alternative to amending the Corporations Act would be to amend Listing Rule 3.1 to clarify that the expression "material effect on the price or value of the entity's securities" does not import the section 677 "influence test". In this manner, an entity's statutory obligation under section 674 to notify the market operator of information "in accordance with [the Listing Rule] provisions" would be discharged having regard solely to the Listing Rule meaning of "material effect".

3.3 Exposure for honest judgment calls

3.3.1 Background

As noted above (para 1), two key principles on which the Listing Rules are based relevant to disclosure refer to timely disclosure of material information and maintaining high standards of integrity of entities and their officers.

In applying these principles, "the Listing Rules necessarily cast a wide net" (chapter 1 of the Listing Rules). The disclosure obligation in Listing Rule 3.1 is cast broadly, and the obligation is immediate. Guidance Note 8 points out that "Listing Rule 3.1 expresses broad principles that cannot be defined with absolute clarity. The rule must be complied with in the 'spirit' of continuous disclosure (Listing Rule 19.2).

This requires "an open and pragmatic working relationship between ASX and listed entities", such relationship being "vital to the integrity of the continuous disclosure framework" (Guidance Note 8, para 4).

As with other ASX Listing Rules, there are necessarily degrees of discretion, commercial understanding and regulatory judgement that need to be applied in the supervision and enforcement of the continuous disclosure requirements of Listing Rule 3.1.

Within this regulatory framework both ASX and ASIC have responsibilities for monitoring enforcement, and the respective responsibilities are recognised in the Memorandum of Understanding between them.[43] ASX has responsibility for monitoring and enforcing compliance by listed disclosing entities with its operating rules, including continuous disclosure. ASIC has responsibility for monitoring and enforcing the provisions of the Corporations Act, including those provisions providing statutory backing to the continuous disclosure provisions. In undertaking these responsibilities, each is doing so from the perspective of obtaining the optimal regulatory outcome.

However as discussed above (para 1.2.4), increasingly, legal action is being taken by private litigants through SHCAs, driven by the development of the Australian third party litigation funding industry, to enforce the ASX continuous disclosure provisions. Private litigants are neither equipped with nor constrained by the same culture, regulatory experience and expertise and administrative accountability as either ASIC or ASX in their enforcement of the ASX continuous disclosure rules.

Whilst the Courts are able to exercise judgement, their ability to act as a fair, efficient and effective enforcement mechanism in the context of private litigation through SHCAs is constrained by two critical factors:

- Courts are obliged to interpret the broad language of the Listing Rules and apply it to the facts at hand, and do not have the same degree of market or regulatory (as opposed to judicial) experience or discretion. Listing Rule

[43] Memorandum of Understanding between Australian Securities and Investments Commission and Australian Stock Exchange, 30 June 2004.

19.2 makes it clear that the Listing Rules should not be interpreted in a legalistic fashion; and

- as noted above (para 1.2.4), to date, no SHCA has proceeded to judgment, and if not withdrawn all have been settled out of court.

3.3.2 Recommendation

For these reasons, we recommend that the Listing Rules be amended so as to diminish the distinction between the circumstances in which a listed entity will be subjected to regulatory enforcement and the circumstances in it might become subject to SHCA proceedings for breach of the ASX continuous disclosure requirements.

One possible way to do this is by introducing a **disclosure judgement rule**, similar to the business judgement rule, into the ASX Listing Rules. If this disclosure judgement rule provided that, in appropriate circumstances akin to those set out in section 180(2) of the Corporations Act, the listed entity did not need to notify ASX of information, then section 674(2) of the Corporations Act would not be enlivened and a listed entity would have a defence to the private right of action.

An entity that makes a disclosure judgement in good faith, reasonably informs itself about the subject matter of the disclosure and rationally believes that the disclosure judgement is in accordance with the Listing Rules should be capable of using that good faith and rational judgement as a defence to a private cause of action. Both the disclosure decision and the exercise of the disclosure judgement would remain subject to the overarching requirements to comply with the spirit and intent of the Listing Rules subject to the supervision of ASX.

The disclosure judgement rule should also provide a degree of protection to a listed entity which ought to have been, but was not, aware of material information, provided that it has taken reasonable steps in the circumstances to ensure compliance with Listing Rule 3.1 and believed on reasonable grounds that it was complying with its obligations under that Listing Rule. In other words, the defence available to individuals under section 674(2B) of the Corporations Act should also be available to entities under the Listing Rules.

Appropriately drafted, such a disclosure judgement rule could preserve the open and pragmatic supervision by ASX of its continuous disclosure rules, as well as ASIC's ability to serve an infringement notice for an alleged contravention of s674(2). This would maintain the current regulatory oversight and enforcement

model, which is a reasonably efficient and effective way to achieve prompt disclosure, swift application of sanctions and remedial action.

Whilst this reform would impact on some potential SHCAs, these are typically instigated long after an event has occurred and play little or no role in ensuring efficient market operation or transparent reporting. Private litigants would remain able to avail themselves of the right to take action for misleading and deceptive conduct under section 1041H of the Corporations Act.

4. Summary

Our recommendations for consideration are summarised below.

Issue	**Change to Guidance Note or ASX practice**	**Substantive Listing Rule or Corporations Act amendment**
Requirement for "immediate" disclosure – section 2.1	Clarification in Guidance Note as interim measure	Listing Rule amendment as long term solution
The impact of a trading halt on disclosure obligations – section 2.2	Clarification in Guidance Note	n/a
A reasonable person would expect information to have a material effect on the price or value of securities – sections 2.3 and 3.2	Clarification in Guidance Note as interim measure	Corporations Act or Listing Rule amendment as long term solution
When an obligation arises to correct material information – section 2.4	Clarification in Guidance Note	n/a
How to deal with expression of an opinion – section 2.5	Clarification in Guidance Note	n/a
How to deal with a variation from analyst consensus forecasts – section 2.6	Clarification in Guidance Note	n/a
How the reasonable person test operates – section 2.7	Clarification in Guidance Note	Listing Rule amendment as long term solution
Price query letter – section 2.8	Change in practice in relation to price query letter	n/a
Exposure for honest judgement call	n/a	Listing Rule amendment

If you have any questions in relation to this submission, please contact the incoming Chairman of the Corporations Committee, Ms Marie McDonald, on (03) 9679 3264.

Yours sincerely

Margery Nicoll
Acting Secretary General
Law Council of Australia

Cc Jim Murphy, Executive Director, Markets Group, Treasury
Belinda Gibson, Deputy Chairman, Australian Securities and Investments Commission
Kate O'Rourke, Senior Leader, Australian Securities and Investments Commission