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Forrest v ASIC: A 'Perfect Storm'

John Humphrey[*] and Stephen Corones[**]

The policy objectives of the continuous disclosure regime augmented by the misleading or deceptive conduct provisions in the Corporations Act are to enhance the integrity and efficiency of Australian capital markets by ensuring equality of opportunity for all investors through public access to accurate and material company information to enable them to make well-informed investment decisions. This article argues that there were failures by the regulators in the performance of their roles to protect the interests of investors in Forrest v ASIC; FMG v ASIC (2012) 247 CLR 486: ASX failed to enforce timely compliance with the continuous disclosure regime and ensure that the market was properly informed by seeking immediate clarification from FMG as to the agreed fixed price and/or seeking production of a copy of the CREC agreement; and ASIC failed to succeed in the High Court because of the way it pleaded its case. The article also examines the reasoning of the High Court in Forrest v ASIC and whether it might have changed previous understandings of the Campomar test for determining whether representations directed to the public generally are misleading.

A Introduction

The stock market run by Australian Stock Exchange Limited (ASX) is an important mechanism for the allocation of capital in the Australian economy. One of the fundamental regulatory underpinnings of the efficient operation of the stock market run by ASX is the continuous disclosure regime which is provided by s 674 of the *Corporations Act 2001* (Cth) in combination with Chapter 3 of the ASX Listing Rules. Under s 674(2) of the *Corporations Act*, listed disclosing entities are required to provide information to the Australian Stock Exchange pursuant to their continuous disclosure obligations, namely information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the entity's securities. The disclosure rules are intended to promote the maintenance of investor confidence through the timely provision of information on the basis of which investors can make informed investment decisions. While there has not been a lot of judicial consideration on the subject, the objective of Australia's continuous disclosure regime has been stated to be :

> 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 to improving the accountability of company management. It is also integral to minimising incidences of insider trading and other market distortions.[1]

ASX has an important role to play in the regulatory regime as the front line regulator of the compliance by listed entities with their disclosure obligations under Chapter 3 of the ASX Listing Rules.

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[1] *James Hardie Industries NV v ASIC* [2010] NSWCA 332 at [355] (Spigelman CJ Beazley JA and Giles JA).

The operation of the continuous disclosure regime is augmented by the operation of Section 1041H of the *Corporations Act* 2001 which deals with misleading or deceptive conduct in connection with any dealings in securities by a person. Section 1041H(1) provides:

> A person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive.

Section 52 of the *Trade Practices Act* 1974 (Cth) (TPA) contained a prohibition of conduct in trade or commerce that was "misleading or deceptive or likely to mislead or deceive". It provided the basis for a statutory cause of action for damages. It has been replaced by s18 of the Australian Consumer Law (ACL). Section 52 of the TPA was the model for s 1041H of the *Corporations Act 2001* (Cth).[2] To determine whether conduct is misleading for the purposes of s 1041H, the Courts apply the same principles that were applied in relation to s 52 of the TPA. The Australian Securities and Investments Commission (ASIC) is the regulator primarily responsible for ensuring that investors in securities are not misled and it closely scrutinises announcements to the market to ensure that they are not misleading.

In March 2006, ASIC commenced proceedings against Fortescue Metals Group Ltd (FMG) and its Chairman and Chief Executive, Mr John Andrew Henry Forrest, for alleged contraventions of ss 674(2) and s 1041H of the *Corporations Act*. ASIC accused Mr Forrest of being personally liable as an accessory to FMG's alleged misleading conduct and breaches of the continuous disclosure rules in relation to three agreements with three Chinese state-owned entities. At first instance, ASIC lost in the Federal Court,[3] but won on appeal to the Full Federal Court.[4] On a further appeal, the High Court unanimously found that FMG and Forrest had not engaged in misleading conduct.[5] About the only things the Full Court and the High Court agreed on in *Forrest v ASIC* were that:

- the reasoning of the trial judge was incorrect; and
- ASIC's pleading had the effect of obfuscating the matters in issue rather than elucidating them.

The decision of the High Court surprised many lawyers who practice in the area who were familiar with facts of the case in that it provided little in the way of guidance in relation to the operation of the continuous disclosure regime in conjunction with s 1041H. The end result is that a vast amount of public money has been spent on litigation to enforce the law with very little to show for it.[6] As has

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[2] *Forrest v Australian Securities and Investment Commission; Fortescue Metals Group Ltd v Australian Securities and Investment Commission* [2012] HCA 39 at [103] (Heydon J).

[3] *Australian Securities and Investments Commission v Fortescue Metals Group Ltd (No 5)* (2009) 264 ALR 201 (Gilmour J).

[4] *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364 (Keane CJ, with whom Emmett and Finkelstein JJ agreed).

[5] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 (French CJ, Gummow, Hayne and Kiefel JJ. Heydon J wrote a separate opinion).

[6] See Durkin, P"ASIC licks wounds from Forrest case" *Australian Financial Review*, 15 May 2013, p 26, who claims that although ASIC has refused to reveal the exact amount spent on its unsuccessful case against FMG and Forrest, in the 2013 Budget "...an additional $30 million was paid into and drawn down from the regulators' 'enforcement special account', which is used to fund major ASIC litigation'.

been observed by other commentators[7] the result would seem to undermine rather than promote good disclosure practice and investor confidence in Australian capital markets.

In this article we argue that there were failures by both ASX and the ASIC in performing their respective regulatory functions relating to the disclosures made by FMG and Forrest. In part C of the article we examine the role played by ASX and argue that timely action by ASX could have dealt with the situation and obviated the need for expensive and ultimately unsuccessful action by ASIC.

Part D considers the role of ASIC's pleadings in the High Court decision and the way in which it framed its cause of action against FMG and Forrest. We argue that the pleadings could have contained additional particulars of alleged misleading conduct which, had they been included, may have significantly influenced the decision reached by the High Court.

Part E looks at the decision of the High Court. We argue that the reasoning of the majority in the High Court decision as regards the impact of public statements by FMG and Forrest on the target audience (which may well be attributable to ASIC's decision to plead the case in the way that it did) did not take into consideration, and appears to be at odds with, relevant movements in the FMG share price. We also discuss the way in which the High Court applied the test in *Campomar Sociedad Limitada v Nike International Ltd* for determining whether representations directed to the public generally, or a segment of the public, are misleading. In *Campomar* the majority, in a joint judgment stated:

> Where the persons in question are not identified individuals to whom a particular misrepresentation has been made or from whom a relevant fact, circumstance or proposal was withheld, but are members of a class to which the conduct in question was directed in a general sense, it is necessary to isolate by some criterion a representative member of that class. The inquiry thus is to be made with respect to this hypothetical individual why the misconception complained has arisen or is likely to arise if no injunctive relief be granted. In formulating this inquiry, the courts have had regard to what appears to be the outer limits of the purpose and scope of the statutory norm of conduct fixed by s 52".[8] (Citations omitted)

The *Campomar* test is an objective test for the court. It is the accepted orthodoxy in misleading conduct cases, including s1041H of the *Corporations Act*.[9] However, in *Forrest v ASIC* the majority in the High Court applied the *Campomar* test on the basis that ASIC had not led evidence as to how actual investors had understood the statements it sought to impugn as misleading or deceptive, or as likely to mislead or deceive. This raises the issue as to whether the High Court is saying that in applying the *Campomar* test in future it will be necessary to call evidence as to how allegedly misleading representations were understood by members of the intended audience. In rejecting ASIC's case the majority speculated as to how investors might have understood the impugned statements although the evidentiary basis for this speculation is not apparent.

B Relevant Facts

On 23 August 2004 a number of things happened. A letter (the 23 August letter) from FMG was received by the ASX at 9:37am. The letter referred to a media release on the FMG website. Then, later that day, Forrest conducted a telephone investor conference (Investor Conference) which dealt with the matters referred to in the 23 August letter and the media release.

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[7] See Baxt R, "Editorial" (2012) 30 C&SLJ 473; Andrews N, "Editorial" (2012) 27 Australian Journal of Corporate Law 123.

[8] *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45 at 85 [103] (Gleeson CJ, Gaudron, McHugh, Gummow, Kirby, Hayne and Callinan JJ).

[9] See *National Exchange Pty Ltd v Australian Securities & Investments Commission* (2004) ATPR ¶42-000 at [18]-[19] applying the test in *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45 at [92]-[106].

The 23 August letter was in the following terms:

> **China signs to build Railway**
>
> *Fortescue Metals Group Ltd ("FMG") is pleased to announce that it has entered into a binding contract with China Railway Engineering Corporation (CREC) to build and finance the railway component of the Pilbara Iron Ore and Infrastructure Project.*
>
> The "Build and Transfer" (BT) contract covers the railway from the Company's iron ore tenements in the Chichester Ranges to the export hub at Port Hedland. The contract covers all earthworks, culverts, bridges, rail, sleeper and rolling stock requirements, with the exception of locomotives which will continue to be sourced internationally and may form an addition to this agreement.
>
> CREC is China's largest construction group, having constructed 40,000 kilometres of rail networks throughout the country. FMG is confident in CREC's ability to build the heavy axle load railway in the Pilbara pursuant to the BT contract. CREC plans to become Asia's top construction company within 3 to 5 years and this contract provides them with a platform for further international growth. CREC has commenced discussions with Australian based engineering construction groups with a view to forming local joint ventures to meet its obligations pursuant to the contract.
>
> We refer to the media release on the Company's website at www.fmgl.com.au.
>
> (Emphasis added)

Relevantly, the Media Release provided:

> ……The contract underwrites the project's independent rail line from Fortescue Metals' mine sites at its massive Chichester Ranges iron ore shipments. CREC will also source and finance the bulk of the rolling stock for the project, providing the platform for the rapid advancement of the project.
>
> 'The further development of the Pilbara has until now been restrained by the lack of an independent railway system. This agreement provides for that vital new infrastructure to be built. Finalising the contract with CREC now paves the way to finance the rest of the project in a plain, vanilla manner should the Company so wish', said Fortescue's Chief Financial Officer, Chris Catlow.
>
> The rail link is the largest component in Fortescue Metal's Pilbara project which also includes a proposed A$410 million iron ore mine and $470 million in new port facilities at Port Hedland.
>
> The President of China Railway Engineering, Mr Qin Jiaming, said from Beijing today that Fortescue Metals' contract presented an excellent opportunity for CREC to develop internationally.
>
> 'This new Pilbara project dove-tails both CREC's short and long-term development strategy', Mr Jiaming said.
>
> 'CREC is fully confident about its capacity to build a heavy axle load railway in the Pilbara, a project able to deliver significant economic benefits to both Australia and China', he said.
>
> The contract covers all earthworks, culverts, bridges, rail, sleeper and rolling stock requirements for the new rail line.
>
> CREC has already commenced discussions in Perth and Beijing with Australian and international engineering and construction groups (operating in Australia) with a view to including minority joint venture interests in the contract.
>
> Locomotives for the Fortescue Metals' railway will continue to be sourced internationally and may form an addition to this agreement.
>
> 'This is the catalyst we have been working on to propel our Pilbara project into real-time construction, project financing and project commencement stages', Mr Forrest said.

> *Under the terms of the contract CREC will take full risk under a fixed price agreement on the rail project* which Fortescue Metals proposes be held separate to the parent company, in a new entity called The Pilbara Infrastructure (TPI)……." (emphasis added)

The investor conference was attended by financial journalists and representatives of institutional investors. The purpose of the Investor Conference was to discuss the 23 August letter and the Media Release.

During the Investor Conference the following exchange took place:

> UNIDENTIFIED: Sorry, what is the project cost of the railway line itself? You talk about it being a 1.85 billion project all up but I mean, how much of that is the railway line?
>
> FORREST: The railway line and the rolling stock, you'll see in the press release that the bulk of the Pilbara infrastructure's rolling stock requirements as well as the entire railway line from the mines in the Chichesters through to the export hub of Port Headland, are all provided for in the contract, *the price of the railway line and the rolling stock is confidential but we are pleased to say it is competitive.*[10]
>
> (emphasis added)

This was a very important representation as to the price under the contract ("the competitive price representation") made to, amongst others, a group of journalists who could be expected to, and who in fact did, report in the Australian financial press on what was said during the Investor Conference. In other words Forrest knew that what he said at the Investor Conference could be expected to be widely disseminated, and it was. To assist an understanding of the competitive price representation it is noted that the Collins English Dictionary defines "competitive" as "sufficiently low in price or high in quality to be successful against commercial rivals"[11]

The next day (24 August 2004) the following reports, all referring to or based on representations made by Forrest at the Investor Conference appeared in the financial press:

> (1) "Andrew Forrest's Fortescue Metals has stepped up its challenge to the BHP Billiton and Rio Tinto dominance of the hugely profitable Pilbara iron ore export industry by striking a deal with a Chinese construction group on a railway for the region….
>
> … Details are few and far between. Speaking after a signing ceremony in China, Mr Forrest would not reveal the price of the deal but said the cost of the mine , rail and port project remained on target."[12]
>
> (2) "Fortescue Metals Group Ltd said China Railway Engineering Corp. will build and assume the railway construction risk for its project in the Pilbara region of Western Australia as part of Fortescue's A$1.85 billion iron ore project. While the terms weren't disclosed, people familiar with the negotiations valued the deal at between A$600 million and A$800 million."[13]
>
> (3) "The binding "build and transfer" contract with China Railway Engineering Corp is the biggest component in Fortescue Metals' project, ….

[10] See Media Monitors – Transcript of Telephone Press Conference held on 23 August 2004 at 12:00 pm.

[11] See Collins English Dictionary online. The adjective 'competitive' is defined in the Macquarie Dictionary (4th ed, Macquarie University, 2005), to mean: 'of, relating to, involving or decided by competition'.

[12] See Fitzgerald. B "Fortescue steps up the pressure" *Melbourne Age,* 24 August 2004.

[13] See "Fortescue Metals Group Ltd.: China Railway Engineering Will Assume Construction Risk" *The Asian Wall Street Journal,* 24 August 2004.

> Speaking from China yesterday, Mr Forrest declined to reveal the price of the deal bit said that the cost of the entire mine, rail and port project remained on target at $1.85 billion.
>
> The state-owned Chinese group will bear full risk under the fixed price contract." [14]

These three reports are only a sample; there were many others.

On the 23 August 2004, following the making of the various representations by FMG and Forrest, FMG's share price had risen from 55 cents to 70 cents (a 27% increase) before closing at 59 cents (a 7% increase).

In March 2005 the *Australian Financial Review* newspaper published an article asserting that the CREC agreement did not impose legally binding obligations on CREC to build, finance and transfer the railway. Following publication of the article the FMG share price fell sharply. The FMG share price at market close on 23 March 2005 was $5.05. The FMG share price at market close on 24 March 2005 was $3.30 (a 37% decrease). On 24 March 2005 ASX wrote to FMG following the publication of the article in the *Australian Financial Review* seeking clarification from FMG about the terms of the CREC agreement. In response to the ASX request for clarification FMG wrote to ASX on 29 March 2005 attaching a copy of the CREC agreement from which it was apparent that there was, in fact, no agreed fixed price.

As noted above in March 2006 ASIC commenced litigation against Forrest and FMG.

C Role of the Australian Stock Exchange

ASX has the primary role in supervising compliance by entities listed on ASX (other than itself) with the various ASX disclosure requirements including the general disclosure requirement found in ASX Listing Rule 3.1.

The basis given by Forrest in the Investor Conference for not disclosing the amount of the agreed fixed price was that it was confidential. However, it is well settled that a listed entity must comply with its disclosure obligations under ASX Listing Rule 3.1 and s 674 of the *Corporations Act*, even where it is party to a confidentiality or non-disclosure agreement that might otherwise require it to keep information confidential unless it can bring itself within the scope of the carve-outs from disclosure in ASX Listing Rule 3.1A in respect of particular information.

To satisfy the requirements of the carve-out from disclosure in ASX Listing Rule 3.1A at the relevant time it was necessary to show that a number of requirements were satisfied. Importantly these include that the relevant information is confidential and that one of the following situations applies:

- it would be a breach of law to disclose the information;
- the information concerned an incomplete proposal or negotiation;
- the information was insufficiently definite to warrant disclosure;
- the information was generated for the internal management purposes of the entity; or
- the information was a trade secret.

None of the five situations specified above applied on 24 August so there can be no argument that the carve outs in ASX Listing Rule 3.1A were applicable to disclosure of the CREC contract price. The

[14] See Tubby, G "Pilbara iron ore dream closer with Chinese deal" *Courier Mail*, 24 August 2004.

fixed price was a material term of an agreement that FMG had announced to the market the previous day and so should have been disclosed.

As noted above on the 23 August 2004 FMG's share price had risen from 55 cents to 70 cents (a 27% increase) before closing at 59 cents (a 7% increase). It should have been obvious to the ASX prior to the commencement of trading on 24 August from the content of the newspaper articles quoted above (and many others) that the market was not properly informed as to the terms of the CREC Agreement – at least as regards the fixed price payable to CREC. It is submitted that ASX should have written to FMG on 24 August requesting immediate clarification as to the agreed fixed price and/or seeking the production of a copy of the CREC agreement. It is hard to see a more fundamental term of the CREC agreement than the supposedly fixed price that Forrest had declined to provide in the Investor Conference and yet despite the plethora of speculative news reports ASX did not write to FMG until 25 March 2005.

Had the ASX written to FMG in August 2004 seeking the appropriate clarifications it is difficult to see that there would have been any basis for the subsequent litigation and good disclosure practice would have been promoted by ASX thereby protecting investors.

D Pleading of the Case by ASIC

It is possible to draw (from the segments of the 23 August letter, the Media Release and the transcript of the Investor Conference highlighted in the discussion of the relevant facts above) a composite set of representations that were in the market following conclusion of the Investor Conference, namely:

> (1) Fortescue Metals Group Ltd ("FMG") …… has entered into a binding contract with China Railway Engineering Corporation (CREC) to build and finance the railway component of the Pilbara Iron Ore and Infrastructure Project.
>
> (2) Under the terms of the contract CREC will take full risk under a fixed price agreement on the rail project.
>
> (3) … the [fixed] price of the railway line and the rolling stock is confidential but we [FMG] are pleased to say it is competitive [sufficiently low in price ….. to be successful against commercial rivals].

The ASIC case seemed to allege a combination of fraudulent misrepresentation, negligent misrepresentation and misleading or deceptive conduct in a 108 page Statement of Claim. Even though ASIC won in the Full Court Keane CJ, as he then was, was critical of ASIC's pleading:

> [16] I should note here that, at trial and in this court, the case was complicated by ASIC's presentation of a number of arguments. Some of these arguments are strong, while others are not. The presentation of alternative arguments is not apt to aid comprehension or coherence of analysis and exposition; indeed, this approach may distract attention from the central issues.[15]

During the appeal it was apparent that the members of the High Court (Hayne J in particular) also had difficulty with the way ASIC had pleaded its case:

> HAYNE J: But at the bottom, should not the regulator in taking a penalty case nail its colours to a mast? Should not the regulator go forward saying "This is misleading or deceptive because"?

[15] *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364 at [16]

MR YOUNG: With respect, no your Honour."[16]

and later

HAYNE J: At some point you might tell me how many permutations and combinations there were in this document, Mr Young? I suspect they run into the thousands, would they not?

MR YOUNG: I have not attempted the exercise, your Honour.

HAYNE J: Where most conveniently do I find the pleading that it was misleading and deceptive not to tell investors that critical matters remained for further agreement?" [17]

When the majority dealt with the matter of the pleadings in its joint judgment it made the following comments:

> Contrary to ASIC's submission in this court, a case of fraud cannot properly be seen as a "fallback" claim to be made against the possibility that that the party accused of engaging in misleading or deceptive conduct by publishing notices in relation to a financial product may seek to characterise them as statements of opinion, not fact. It is fundamental, and long established, that if a case of fraud is to be mounted, it should be pleaded specifically and with particularity. A pleading of fraud will necessarily focus attention on what it was that the person making the statement intended to convey by its making. And the pleading must make it plain that it is alleged that the person who made the statement knew it to be false or was careless as to its truth or falsity. If an alternate case of misleading or deceptive conduct is to be advanced, it is necessary to identify that claim as separate from the allegation of fraud. And for the purposes of the misleading or deceptive claim the pleader must identify what it is alleged that the impugned statements conveyed to their intended audience. Of course there may be circumstances in which it is appropriate to plead alternative cases of misleading or deceptive conduct or of fraud and misleading or deceptive conduct. But it is greatly to be doubted that it will ever be appropriate to pile, one on top of the other, as many alternative allegations as were made in this case. …
>
> The task of the pleader is to allege the facts said to constitute a cause of action or causes of action supporting claims for relief. Sometimes that task may require facts or characterisations of facts to be pleaded in the alternative. It does not extend to planting a forest of forensic contingencies and waiting until final address or perhaps even an appeal hearing to map a path through it. In this case, there were hundreds, if not thousands, of alternative and cumulative combinations of allegations. …
>
> As already noted, ASIC's allegations were taken, at trial, to be allegations of fraud. Yet on appeal to the Full Court of the Federal Court, and again on the appeals to this court, ASIC advanced its case on the wholly different footing that the impugned statements should be found to be misleading or deceptive. That is, whereas the case that was presented at trial focused upon the honesty of Fortescue, its board and Mr Forrest, the case which ASIC mounted on appeal focused on what it was that the impugned statements would have conveyed to their intended audience.[18]

The plethora of contingencies contained in the Statement of Claim obviously did not assist ASIC to clearly expound its case on the appeal. Interestingly, ASIC had not pleaded the "competitive price representation" made at the Investor Conference as a particular of its misleading or deceptive case under s1041H. Instead, ASIC sought to make its case under s1041H by relying on certain other

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[16] *Forrest v Australian Securities and Investments Commission; Fortescue Metals Group Inc v Australian Securities and Investments Commission* [2012] HCATrans 84 (30 March 2012) page 10 of 71

[17] *Forrest v Australian Securities and Investments Commission; Fortescue Metals Group Inc v Australian Securities and Investments Commission* [2012] HCATrans 84 (30 March 2012) page 13 of 71.

[18] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 (French CJ, Gummow, Hayne and Kiefel JJ at [26] - [28].

specified statements made in relation to the 23 August 2004 letter and the Media Release ("ASIC impugned statements").

Given the majority judgment in relation to the effect of the ASIC impugned statements on investors, the failure to plead the "competitive price representation" may have been a fatal flaw. It would seem difficult to resist the argument that the "competitive price representation" was misleading for the following reasons. Though not pleaded as one of the particulars of the misleading or deceptive case (i.e. an ASIC impugned statement), ASIC, during argument, sought to use the representations at the Investor Conference including the "competitive price representation" as surrounding statements that would have influenced the way in which the ASIC impugned statements were received:

> …and then there is the statement about the price being confidential "but we are pleased to say it is competitive" at 1291 at about line 26. That statement about the price not being disclosed was widely reported and published in conjunction with the publication and media reports of 23 August media release…
>
> …
>
> Now, the recipients knew nothing about the actual mechanisms in the franchise agreement. They are receiving a message that a contract has been entered into containing build and finance obligations and in that context a statement is made by Forrest that the price is confidential but we are pleased to say it is competitive. So that is part of the surrounding statements that would influence the way in which the message is received…..
>
> …. All these statements, in our submission, are in the nature of statements concerning accomplishments, events that have been achieved.[19]

Dealing with the "competitive price representation", Forrest made the following submissions on the matter:

> Could we just say this, your Honours. The mechanism of the agreement made it very likely that the ultimate price would be competitive and made it apparent it would be **competitive** because he had to get two parties to agree. If they could not agree, an independent person would decide, no doubt, upon the basis of what was a *reasonable* price. …. *Again, this was not something pleaded as a particular of misleading conduct, but what was said was also correct.*[20][emphasis added].
>
> In other words, the competitive price representation could not be utilised by ASIC to establish its case for two reasons. First, what Forrest said (i.e. the competitive price representation) was correct because the representation should have been understood as a representation relating to a future price to be agreed pursuant to a mechanism in the CREC agreement rather than an already agreed price. If that submission was not accepted then, secondly, and in any event, the competitive price representation had not been pleaded by ASIC as a particular of misleading conduct and so could not be relied upon.

The major problem with the first submission as to the price being regarded as a future matter to be determined in accordance with the mechanisms in the CREC agreement is that it is plainly inconsistent with the newspaper reports of the Investor Conference published on 24 August – in other words a group of the people who were on the Investor Conference call (financial journalists) clearly thought that Forrest was saying that there was an agreed price and they did not understand him to be

[19] *Forrest v Australian Securities and Investments Commission; Fortescue Metals Group Inc v Australian Securities and Investments Commission* [2012] HCATrans 49 (1 March 2012) page 51 of 75.

[20] *Forrest v Australian Securities and Investments Commission; Fortescue Metals Group Inc v Australian Securities and Investments Commission* [2012] HCATrans 48 (29 February 2012) page 60 of 74.

saying that the price was still to be agreed. The majority in the High Court, though not deciding the matter, seemed unpersuaded by this submission:

> Nor is it necessary to decide whether, as Fortescue and Mr Forrest submitted, the framework agreements did provide for mechanisms by which those matters could be determined. It is enough to say that, contrary to the arguments of Fortescue and Mr Forrest, the better view would be that cl 1.2 of the framework agreements did not provide such a mechanism. …[21]

It is worth observing that even if the submission as to the "competitive price representation" being a representation in relation to a price to be agreed in the future had been accepted as correct there is a good argument that the operation of section 769C[22] of the *Corporations Act* would render it misleading. The terms "reasonable" and "competitive" used by Mr Jackson QC in his submission are not the same and it is hard to see the reasonable basis required by section 769C for the representation that the price, when arrived at, would be "competitive".

Importantly though and in the final event, the High Court did not deal with the "competitive price representation" because it didn't have to, given the way the case had been pleaded by ASIC.

E High Court Decision

ASIC chose to focus its "misleading or deceptive" case on whether it was misleading to represent that the CREC agreement was a "binding contract".

The majority in the High Court applied the *Campomar* test noting that ASIC had not led evidence as to how investors would have understood the references to a "binding contract" in the impugned statements. In rejecting ASIC's case the majority speculated as to how investors might have understood the impugned statements although the evidentiary basis for this speculation by the majority is not apparent.

Binding Contract Representation

The majority put the issue in the following terms:

> Would they as the Full Court assumed, ask a lawyer's question and look not only to what the parties had said and done but also to what could or would happen in a court if the parties to the agreement fell out at some future time? Or would they take what was said as a statement of what the parties to the agreements understood they had done and *intended* would happen in the future? The latter understanding is to be preferred.[23]

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[21] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 (French CJ, Gummow, Hayne and Kiefel JJ at [52].

[22] Section 769C of the *Corporations Act* 2001 provides:

> (1) For the purposes of this Chapter, or of a proceeding under this Chapter, if:
>
> a) a person makes a representation with respect to any future matter (including the doing of, or refusing to do, any act); and
>
> (b) the person does not have reasonable grounds for making the representation;
>
> the representation is taken to be misleading.

[23] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 (French CJ, Gummow, Hayne and Kiefel JJ at [37]

What the parties understood they had done in this context was enter into a binding contract to build and finance the railway component of the Pilbara Iron Ore and Infrastructure Project under which CREC would take full risk for a fixed price.

The majority concluded:

> For the submission was that, although the impugned statements accurately recorded that the parties to each framework agreement had made an agreement which said that the bargain was, and was intended by the parties to be, legally binding, the impugned statements were misleading statements were misleading or deceptive or likely to mislead or deceive because they also conveyed to their intended audience a larger message. This was that the agreements that the parties had made were not open to legal challenge in an Australian Court. The broader proposition should not be accepted. The impugned statements conveyed to their intended audience what the parties to the framework agreements had done and said they had done. No further message was shown to have been conveyed to an "ordinary or reasonable" member of that audience.[24]

This conclusion is surprising given the sharp downward movement in the FMG share price following publication of the *Australian Financial Review* article asserting that the CREC agreement did not impose legally binding obligations on CREC. Logically, if the reasoning of the majority in the High Court was correct there should have been little effect on the FMG share price caused by the *Australian Financial Review* article. The material decrease in the FMG share price suggests that investors were indeed concerned by the legal effect of the CREC agreement, and that the assertion in the newspaper article that the CREC agreement did not impose legally binding obligations on CREC to build, finance and transfer the railway was contrary to their previous understanding as to the legal effect of the agreement.

It may be that the passage cited above should be construed narrowly so that the majority decision is not that there was no larger message conveyed to an "ordinary or reasonable" member of the audience by the impugned statements but rather that ASIC had not shown that there was a larger message. Given the importance of continuous disclosure to the proper functioning of Australian capital markets and given that the FMG shareholders seem to have indicated by the share price fall that they did care whether the CREC agreement created enforceable obligations it is respectfully submitted that such an approach is unsatisfactory. However, if the narrow construction is the correct approach then that result would again be attributable to the way ASIC had pleaded and run its case. This approach would also have implications for the way the way the *Campomar* test will be applied in future.

The Campomar test?

The majority decision did not endorse the approach of the trial judge which gave effect to the fact/opinion distinction. The majority did not think that it was helpful or necessary first to characterise statements about the content of documents as statements of "fact" or statements of "opinion":

.it is ultimately unprofitable to attempt to classify the statement according to some taxonomy, no matter whether that taxonomy adopts as its relevant classes fact and opinion, fact and law, or some mixture of these classes. It is necessary instead to examine more closely and identify more precisely what it is that the impugned statements conveyed to their audience.[25]

[24] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 (French CJ, Gummow, Hayne and Kiefel JJ at [43].

[25] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [33].

The majority's approach is contained in two general propositions. According to the first general proposition:

> What message is conveyed to the ordinary or reasonable member of the intended audience cannot be determined without a close and careful analysis of the facts. In this, as in so many other areas, the facts of and evidence in the particular case are all important. [26]

According to the second general proposition:

> ... for the purposes of a claim of misleading or deceptive conduct, if a person seeks to characterise a public statement as a representation about the content of a document, the critical question will be what the statement conveyed to its intended audience, not what the party concerned says that it was intended to convey. Concerns about dishonesty provide no reason to distort settled understandings about misleading or deceptive conduct. [27]

The High Court majority rejected ASIC's allegation that the CREC Framework Agreement was not one "to build and finance" the railway.[28] The majority held that the expression was used by the parties in the recitals and in Clause 1 of the agreement, and was "an accurate general description of the agreement they had then made". [29]

The High Court majority then focused on whether the impugned statement that the parties to the CREC Framework Agreement had made a "binding contract" was misleading. This turned on what the impugned statement conveyed to the intended audience. The High Court majority identified the target audience in very broad terms as "...investors (both present and possible future investors) and, perhaps, as some wider section of the commercial or business community".[30] As regards the effect of the effect of the statements on a reasonable member of the target audience the majority observed:

> It is, however, necessary to bear firmly in mind that the impugned statements were made to the business and commercial community. What would *that* audience make of the statement that FMG had made a binding contract with an entity owned and controlled by the People's Republic of China?[31]

The High Court majority concluded:

> The impugned statements conveyed to their intended audience what the parties to the framework agreements said they had done — make agreements that they said were binding — and no more. ASIC did not demonstrate that members of the intended audience for the impugned statements would have taken what was said as directed in any way to what the parties to the agreements could do if the parties were later to disagree about performance. ASIC did not demonstrate that the impugned statements conveyed to that audience that such a disagreement could and would be determined by Australian law. And given that the impugned statements did accurately convey what the parties to the framework agreements had said in those agreements, it would be extreme or fanciful for the audience to understand the impugned statements as directing their attention to any question of enforcement by an Australian court if the parties later disagreed.

[26] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [69].

[27] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [70].

[28] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [14]- [17].

[29] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [16].

[30] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [36].

[31] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [48].

> Such an extreme or fanciful understanding should not be attributed to the ordinary or reasonable member of the audience receiving the impugned statements.[32]

The essential difference between the joint reasons of the High Court majority and the Full Federal Court is that the Full Federal Court considered that the impugned statement would have conveyed to the intended audience a representation about the legal enforceability of the CREC Framework Agreement in the Australian courts.[33] The High Court majority held that the intended audience would not regard them as statements about the legal effect of the agreements under Australian law or any other law. They were statements about what the parties understood they had done, and intended would happen in the future.

ASIC's Pleaded Target Audience

ASIC submitted that whether FMG's disclosures were misleading was to be judged by reference to a reasonable member of the relevant class, namely 'common investors'.[34] The High Court majority defined the intended class as '...investors (both present and possible future investors) and, perhaps, as some wider section of the commercial or business community'.[35] Such a disparate class constitutes a broad cross- section of the investing community from the most astute and well-informed institutional investor at one end of the spectrum, to the less well-informed, private individual investor relying on the media for information at the other end of the spectrum. Does the hypothetical 'reasonable' member of such a heterogeneous class represent some mid-point on the spectrum of investors – an average member of the group? Heydon J, in a separate opinion, expressed the view that a reasonable member of the target audience was 'tough, shrewd and sceptical'.[36] This is a very robust standard by which to judge the impugned statements, and suggests a member towards the top end of the spectrum. Are all investors expected to be rational and circumspect? If so, the 'reasonable investor' test will leave many so-called 'Mum-and -Dad' investors unprotected.

The test is objective, but it will be applied to the particular circumstances of the case. If the conduct at issue is directed at a clearly identifiable group of investors who are particularly vulnerable, the 'reasonable investor' test will be relaxed and applied by reference to a reasonable member of that group who may be more credulous than investors generally.[37]

The applicant bears the onus of identifying the relevant class and the attributes of a reasonable member of the class. ASIC did not attempt to plead that there was a relevant class of private individual investors, so-called 'Mum and Dad' investors, who may have been less well-informed and more vulnerable than the institutional investors. In the absence of facts and evidence, the courts exercise their own value judgments as to the width of the relevant class and how a reasonable investor within the class would be affected by that information.

ASIC's Lack of Evidence

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[32] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [50].

[33] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [35].

[34] *Australian Securities and Investments Commission v Fortescue Metals Group Ltd (No 5)* (2009) 264 ALR 201 at [674].

[35] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [36].

[36] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [105].].

[37] *National Exchange Pty Ltd v Australian Securities & Investments Commission* (2004) ATPR ¶42-000.

Having emphasised that "the facts of and evidence in the particular case are all important", [38] the High Court majority was critical of the absence of facts and evidence presented by ASIC. The High Court majority noted that no evidence had been led by ASIC which would demonstrate that the intended audience would understand "binding contracts" to mean contracts enforceable in a court. The majority stated:

> There was no evidence led at trial to show that investors or other members of the business or commercial community (whether in Australia or elsewhere) would have understood the references in the impugned statements to a "binding contract" as conveying not only that the parties had agreed upon what they said was a bargain intended to be binding, but also that a court (whether in Australia or elsewhere) would grant relief of some kind or another to one of the parties if, in the future, the opposite party would not carry out its part of the bargain.[39]

This criticism is somewhat surprising in the light of the pre-existing case law. It was a well-established principle that where the impugned statements were directed towards the public, or a segment of the public, evidence may be given by members of that audience that they were, in fact, misled. However, according to Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd*,[40] whether conduct is misleading or deceptive, or likely to mislead or deceive is to be determined by the court objectively.

Evidence of how actual investors in the intended audience construe or interpret public statements is relevant to the question of whether the representations contained within them is misleading, even though the test is an objective one for the court. This can be provided by calling witnesses who were misled and entered into a transaction because the information was presented in a complex way, or qualified in some way that was not obvious. For example, in *National Exchange Pty Ltd v Australian Securities & Investments Commission*,[41] ASIC led evidence concerning the reactions of a number of shareholders to the two dollar offers, two of whom were confused or misled at least temporarily.[42] As regards this evidence, Dowsett J stated:

> There is evidence that both Mr Locke and Ms Normoyle were at least temporarily misled by the offer. It is not clear whether this was as a result of the impact upon them of the format of the offer or as a result of their not giving sufficient attention to the payment provision. It would be wrong to place great weight on their having been misled. Further, there is no evidence of any substantial number of people having been misled. It is also relevant to give some weight to the factors addressed by his Honour as possibly explaining that fact, namely that there was a media release, warning of the offer and the increase in share price.[43]

It is unclear why ASIC did not call witnesses who were misled by the binding contract representation in *Forrest v ASIC.* Following the 37 per cent decrease in price on 24 March 2005 after it was asserted in the *Australian Financial Review* that the CREC agreement was not legally binding, it would have

[38] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [69].

[39] *Forrest v Australian Securities and Investment Commission* [2012] HCA 39 at [39].

[40] (1982) 149 CLR 191 at 198-199.

[41] *National Exchange Pty Ltd v Australian Securities & Investments Commission* (2004) ATPR ¶42-000.

[42] *National Exchange Pty Ltd v Australian Securities & Investments Commission* (2004) ATPR ¶42-000 at [7].

[43] *National Exchange Pty Ltd v Australian Securities & Investments Commission* (2004) ATPR ¶42-000 at [41].

been possible for ASIC to identify and interview FMG shareholders and sought statements from them as to what they understood the "binding contract" representation to mean when it was originally made.

E Conclusion

The regulators failed in their duty to protect the interests of investors in *Forrest v ASIC*. The ASX failed to enforce timely compliance with the continuous disclosure regime and ensure that the market was properly informed by seeking immediate clarification from FMG as to the agreed fixed price and/or seeking production of a copy of the CREC agreement. ASIC failed to succeed in the High Court because of the way it pleaded its case and did not pursue the "competitive price" representation, when it was strongly arguable that the competitive price representation was misleading or deceptive, or likely to mislead or deceive.

The orthodox approach to establish whether a public statement is misleading or deceptive is that adopted by the High Court in *Campomar Sociedad Limitada v Nike International Ltd.*[44] In *Forrest v ASIC* the High Court affirmed that applicant bears the burden of proving that an advertisement or public statement contains a representation, and proving what message that representation is likely to convey to a reasonable member of the target audience. However, the High Court majority's criticism of ASIC for failing to lead evidence that some investors were actually misled by the "binding contract" representation suggests that in future a new evidentiary requirement is being imposed under the *Campomar* test.

The High Court did not have to consider the "competitive price" representation because it was not pleaded by ASIC. It decided that FMG and Forrest had not engaged in misleading conduct in relation to the binding contract representation. The intended audience would have construed the impugned statements as statements of the parties' intentions as to what would happen under the CREC agreement, and that had no implications for the legal effect of the agreement if the parties fell out at some future time. This is surprising given the evidence of a 37 per cent drop in the FMG share price in March 2005 following the publication in the *Australian Financial Review* asserting that the CREC agreement did not impose legally binding obligations on CREC.

The policy objectives of the misleading or deceptive conduct provisions in the *Corporations Act* and the continuous disclosure regime are to enhance the integrity and efficiency of Australian capital markets by ensuring equality of opportunity for all investors through public access to accurate and material company information to enable them to make well-informed decisions. All Australians are effectively forced to invest in publicly listed companies because of the compulsory superannuation system.

However, the legalistic approach adopted by the High Court in *Forrest v ASIC* in ascribing a degree of sophistication to reasonable investors seems to promote a 'caveat emptor' approach to investment in our capital markets. In our view this is a retrograde step and contrary to the policy objective of providing protection for all investors, not just the shrewd and the astute. A significant body of shareholders may not be as rational and circumspect as the High Court assumed.

From the perspective of investor protection, the combined effect of the approaches taken by the regulators, ASX and ASIC, and the High Court, in *Forrest v ASIC* has resulted in a "perfect storm".

[44](2000) 202 CLR 45 at [97]-[107].