

CONTINUOUS DISCLOSURE FOR AUSTRALIAN LISTED COMPANIES

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ABSTRACT

This thesis investigates the legal and theoretical basis of continuous disclosure regulation in Australia as it applies to listed companies. An empirical study is undertaken to further investigate the operation of the legislation. As part of the Enhanced Disclosure regime, the continuous disclosure provision was effective from 5 September 1994 as s1001A of the *Corporations Law*, now the *Corporations Act 2001* (Cth). This statutory provision is replaced by s674, inserted by Schedule 2 to the *Financial Services Reform Act 2001* (Cth), and effective from 11 March 2002. The provision reinforces Australian Stock Exchange (ASX) listing rule 3.1. The rule requires a listed disclosing entity to notify ASX immediately of information that would be expected to have a 'material effect' on the share price of the company.

However, the disclosure requirement is weakened by a number of specific exemptions or 'carve-outs' to listing rule 3.1. If a reasonable person would not expect the information to be disclosed, and if the confidentiality of the information is maintained, then disclosure is not mandatory in special circumstances.

This study analyses 427 query notices, issued by ASX to listed companies from July 1995 to April 1996. The queries request information concerning unexplained movements in a company's share price or a failure to comply with the listing rules. An analysis of the companies' replies to these notices provides a profile of the type of company that is likely to be queried. The study also attempts to evaluate the extent to which these companies have relied on the 'carve-outs' as an exemption to the regulation.

ACKNOWLEDGEMENTS

I wish to acknowledge the initial assistance of Professor Terry Walter, in suggesting continuous disclosure as the general topic of the thesis, and Professor Philip Brown for providing the list of dates and company codes on which this study is based. I am especially grateful to Professor Walter for assuming the responsibility of associate supervisor, for his positive and critical comments and for guiding the final statistical analysis of this study. I also wish to convey my appreciation to Dr Joyce Burcham for her interest and advice in establishing the original statistical analysis and to Philip Lee for his direction on the revisions.

Finally, I wish to extend my gratitude to my law supervisors. To Professor Terry Carney for his encouragement during the coursework subjects of this doctorate, to Professor Dimity Kingsford Smith for her time and expertise throughout the project, and to Saul Fridman for his support in the final stages of the thesis.

CONTINUOUS DISCLOSURE FOR AUSTRALIAN LISTED COMPANIES

CHAPTER 1

Introduction

In June 1991, the Attorney General, Michael Duffy, commissioned the Companies and Securities Advisory Committee (CASAC) to evaluate the need for a statutory based regime of continuous disclosure. If implemented, this regime would require companies, and other reporting entities, to publicly release relevant corporate information on a continuous basis. The means by which these requirements could be implemented were also to be examined.¹ Later that year, CASAC issued a report on Enhanced Statutory Disclosure² that proposed a number of reforms³ to the *Corporations Act*⁴.

CASAC is an advisory committee to the Minister established under Part 9 of the *Australian Securities and Investments Commission Act 1989* (Cth) (ASIC Act). The chairman of the Australian Securities and Investments Commission (ASIC)⁵ is a member of the Advisory Committee and other members

¹ Parliament of the Commonwealth of Australia *Corporate Practices and the Rights of Shareholders* Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs Canberra AGPS November 1991 (Lavarch Report) at 17 par 1.3.29.

² Companies and Securities Advisory Committee (CASAC) *Report on an Enhanced Statutory Disclosure System* Sydney September 1991 at 1. Hereafter referred to as CASAC (1991).

³ CCH Australia Limited 'Enhanced Statutory Disclosure Report' *ASC Releases* CASAC 91/03 4-006 27 September 1991.

⁴ Following the commencement of legislation that referred relevant State and Territory powers to the Commonwealth, the *Corporations Act 2001* (Cth) replaced the *Corporations Law*, part of the National Scheme Laws, from 15 July 2001. Unless otherwise stated all section numbers refer to provisions in the CCH Australia Limited 1998, 2000, 2001 and 2002 editions, hereafter referred to as the *Corporations Act*.

⁵ The Australian Securities Commission changed its name on 1 July 1998 to the Australian Securities and Investments Commission following enactment of the *Financial Sector Reform (Consequential Amendments) Act 1998* (Cth). The regulator operates under the *Australian Securities and Investments Commission Act 1989* (Cth) (ASIC Act). The name change was the result of recommendations to expand its responsibilities that were contained in the Wallis Report (Parliament of the Commonwealth of Australia *Financial System Inquiry Final Report: Overview* Canberra AGPS March 1997).

are selected on a part-time basis for their experience in business, company administration, law, accounting and economics.⁶

The CASAC (1991) report recommended enhanced half-yearly disclosure but discarded a concept of compulsory quarterly reporting for all companies.⁷ The Advisory Committee decided that more frequent periodic reporting by all listed companies was not warranted at that stage but the possibility of its introduction should be kept under constant review.

Instead, the CASAC (1991) report recommended that directors of disclosing entities be required to make immediate disclosure to ASIC of any ‘material information’ concerning their company. The report also recommended that due diligence requirements should be imposed on directors to encourage them to effect the necessary internal reporting mechanisms that would enable continuous disclosure to take place.⁸

Proposals were included in the Corporate Law Reform Bill (No 2) 1992 and introduced into Federal Parliament on 26 November 1992, with time allowed for further debate and public consultation.⁹ These recommendations resulted in the *Corporate Law Reform Act 1994* (Cth), which amended the *Corporations Act* and introduced the Enhanced Disclosure (ED) regime, effective 1 July 1994.¹⁰ Under these amendments, s111AC(1) considered a body to be a disclosing entity for the purposes of the *Corporations Act* if any securities of the body were termed ‘ED’ securities. ED securities are defined to include a class of securities that are quoted on a stock market of a securities exchange (s111AE(1)).¹¹

⁶ ASIC Act ss145, 146 and 147. These provisions were subsequently amended by the *Financial Services Reform Act 2001* (Cth).

⁷ Australian Stock Exchange Limited *ASX Listing Rules 1 July 1996 – 30 September 2001*: ASX listing rules 5.1-5.3 requires a mining company to complete a report and give it to ASX within one month after the end of each quarter of its financial year. Listing rule 4.7B also requires entities that are listed on the basis of certain commitments to provide quarterly cash flow reports.

⁸ CASAC (1991), note 2 at 1.

⁹ Baxt R, HAJ Ford and AJ Black *Securities Industry Law* Sydney Butterworths 4th ed 1993 at 65.

¹⁰ *Corporate Law Reform Act 1994* (Cth) Schedule 1 Amendments to the Corporations Law Relating to Enhanced Disclosure.

¹¹ The *Financial Services Reform Act 2001* (Cth) amends s111AE(1) to refer to ED securities, either quoted or suspended that are included on the official list of a prescribed financial market: *Financial Services Reform Bill 2001 Explanatory Memorandum 39202* Parliament of the Commonwealth of

Effective 5 September 1994,¹² the ED regime then introduced the continuous disclosure provision, s1001A,¹³ to reinforce Australian Stock Exchange (ASX) listing rule 3.1.¹⁴ The ASX requirement was rule 3A(1) prior to simplification of the listing rules on 1 July 1996. Both the provision and the revised listing rule 3.1 require directors of listed companies to notify ASX immediately of material information that would be expected to affect the share price of the company. ASX has authority to suspend a company's securities or remove the company from the Official List for a breach of the listing rules.¹⁵

Formerly, intentional or reckless contravention by a listed disclosing entity under s1001A(2) could be deemed an offence under s1001A(3).¹⁶ For a failure to disclose, the company could incur primary liability and a corporate penalty under s1312.¹⁷ As discussed in Chapter 5,¹⁸ secondary liability can be extended to directors and others involved in the offence. The general statutory penalty provision, s1311, and Schedule 3 of the *Corporations Act* provide for a fine and imprisonment for up to five years for such an offence.¹⁹ Continuous disclosure in this context refers to irregular reporting necessitated by a specific event or a change in the company's condition.

Australia, House of Representatives 5 April 2001 at 18.5, 18.6 and *Revised Explanatory Memorandum* 42243.

¹² Ibid, introduced by par 92 of Schedule 1 of the Act; Australian Securities and Investments Commission 'Fundraising: Transition to Corporate Law Reform Act 1994' *ASIC Practice Notes* PN 53.4 17 August 1994 at 1.

¹³ See Appendix 1 for ss1001A-D/674-678.

¹⁴ See Appendix 2 for ASX listing rule 3.1. Unless otherwise stated, all references to the stock exchange are references to ASX.

¹⁵ See section on *ASX Enforcement* in Chapter 5.

¹⁶ Section 1001A(3)/674(2) Note 1. Section 1311(1), also s9 states that an 'offence' means an offence against the law of the Commonwealth or a State or Territory. *A Concise Dictionary of Law* OUP states that an offence is a crime. The modern tendency is to refer to crimes as offences.

¹⁷ See note 19.

¹⁸ See Section 1001A/674 Liability in Chapter 5.

¹⁹ Schedule 3 Penalties: 200 penalty units or imprisonment for five years or both. Section 1311(1A)(da), (1A)(db) applies Schedule 3 penalties to Chapter 6CA Continuous Disclosure and Chapter 7 Financial Services and Markets. Penalties for bodies corporate are five times the maximum pecuniary penalty for that offence (s1312). A penalty unit is \$110 (s4AA(1) of the *Crimes Act* 1914 (Cth)).

The *Financial Services Reform Act 2001* (Cth) was passed by Federal Parliament on 23 August 2001, was proclaimed on 8 October 2001 and commenced on 11 March 2002.²⁰ This legislation amends the *Corporations Act* by transferring the continuous disclosure provision from its present position in Chapter 7, Part 7.11 Division 2 on Prohibited Conduct, to a new Chapter 6CA²¹ that is placed prior to Chapter 6D on Fundraising and its associated disclosure documents.

The amended continuous disclosure provision for listed entities is s674, which in purpose and format is similar to the former s1001A.²² The most notable alteration is found in s674(2) Note 2,²³ which nominates the subsection as a civil penalty provision. The extension of the civil penalty regime by the *Financial Services Reform Act* is further discussed in Chapters 5 and 6. As most of this thesis refers to material available prior to the close of 2001, reference is made to the provisions of the *Corporations Act* at that time, followed by the appropriate section number²⁴ that applies after the introduction of the *Financial Services Reform Act*. Exceptions to this format may occur if there is reference to the old provisions in the historical sense or there is a comparison between the provisions prior to and after the amendments.

Section s1001A/674 was designed to enforce continuous disclosure by ‘listed disclosing entities’ only. ASX listing rule 3.1 imposes the obligation for disclosure on an ‘entity’. Such an entity has applied for admission, or is already admitted, to the Official List of the stock exchange.

A companion provision, s1001B/675, regulates continuous disclosure by unlisted or other disclosing entities where an entity becomes aware that the information is not generally available. If a reasonable person would expect it to have a material effect on the price or value of ‘ED securities of the entity’, then the entity must lodge a document containing the information with ASIC as soon as practicable.

²⁰ Australian Securities and Investments Commission ‘What is the FSRA?’ *ASIC Policy and Practitioners Financial Services Reform* 8 October 2001; ‘Supplement to Building the FSRB Administrative Framework (April 2001)’ 11 September 2001 at 3; *ASIC Media Release* 01/418 28 November 2001.

²¹ *Financial Services Reform Bill 2001*, Schedule 2 Continuous Disclosure at 558.

²² *Explanatory Memorandum*, note 11 at 18.11.

²³ *Financial Services Reform Bill 2001*, note 21, Schedule 2 Continuous Disclosure at 558 line 26.

²⁴ This method of assisting readers with ‘the transition from the old to the new legislation’ was previously used in Ford HAJ, RP Austin *Principles of Corporations Law* Sydney Butterworths 5th ed 1990 at vii.

Disclosure under s1001B/675 does not form part of this study. All entities in the sample are listed companies, with the exception of one listed trust.

Thesis

Topic

The ED regime was initially conceived to demand compliance from certain non-listed companies that did not have to fulfil the disclosure requirements of the ASX listing rules. More importantly to this study, the legislation also reinforces compliance with the listing rules for companies whose securities are quoted on the stock exchange. These regulatory amendments were designed to improve the quality and timeliness of corporate disclosure to the stock market, thereby increasing the value of information to analysts and investors.

Following the implementation of the ED regime, the total amount of material disclosed to ASX by listed companies increased substantially.²⁵ For various standardised periods between 5 September 1992 and 31 March 1996, the CASAC *Report on Continuous Disclosure*²⁶ indicates a 20 per cent post-ED increase in price sensitive documents released to ASX, while non-price sensitive releases increased by 36.6 per cent. However, much of this disclosure is in the form of additional periodic reporting required by statute under the ED regime or by ASX listing rules. Overlap and duplication of information could account for a considerable portion of this disclosure.

ASX noted, in a submission to CASAC, an increase in general disclosure as a result of the ED regime, but the stock exchange did not distinguish between continuous disclosure and other forms of disclosure.²⁷ ASX implied from the increased disclosure that the majority of listed entities did understand and comply with their disclosure obligations.²⁸

²⁵ Brown P, SL Taylor and TS Walter 'The Impact of the Enhanced Disclosure Regime on Corporate Disclosure Policies' May 1996 in Companies and Securities Advisory Committee (CASAC) *Report on Continuous Disclosure* Sydney November 1996 Appendix 8 at 1.

²⁶ Companies and Securities Advisory Committee (CASAC) *Report on Continuous Disclosure* Sydney November 1996 Appendix 8 at 21, Table 1 Panel B. Hereafter CASAC (1996).

²⁷ Hambleton D 'Continuous Disclosure for Listed Entities CASAC Report - It Works' (1997) 15 *Company and Securities Law Journal* 55-63 at 62 refer to n39.

²⁸ ASX submission par 5.1 cited in Hambleton, note 27 at 59.

The effectiveness of this form of continuous disclosure regulation is contestable. This study will consider whether the regulatory regime of s1001A/674, introduced in 1994 with statutory penalties and companion listing rule 3.1, is any more effective than the earlier version of listing rule 3A(1).

Perhaps, notwithstanding all the regulatory effort involved in the s1001A/674 amendment to the *Corporations Act* and the addition of ‘carve-outs’ to listing rule 3.1, the level of timely and meaningful disclosure is no greater than that which could have been achieved under listing rule 3A(1) prior to 1994?

I will bring evidence and argument to support the contention that continuous disclosure under s1001A/674 and listing rule 3.1 has been of limited effectiveness as a form of regulation. I will argue that this is the case because:

- (i) there have been failures by directors to make timely disclosure under s1001A/674, relying on the exemptions or ‘carve-outs’ in listing rule 3.1.3; and**
- (ii) under these ‘carve-outs’, there have been failures to maintain the confidentiality of the undisclosed information as required by s1001A/674 and listing rule 3.1.2.**

Motivation

This study is significant as it investigates the queries made by ASX to listed companies and this should reveal additional information on the effectiveness of continuous disclosure. The study isolates a number of instances where there are possible breaches of the law. Qualitative information, such as the reason for an ASX query to a company and the explanation subsequently given in the reply, cannot easily be obtained by quantitative methods alone.

In this thesis empirical evidence is used to evaluate reliance of directors on the exemptions or confidentiality ‘carve-outs’ included in ASX listing rule 3.1. As a result of these listing rule exemptions, certain corporate information is excluded from a company’s disclosure obligation and does not need to be released to the market. In the 427 instances examined in this study, ASX requested further information from a company once it has been alerted²⁹ to a possible lack of disclosure:

- by unexplained price or volume movements in certain stocks, or
- by ASX officers recognising the need for further clarification of existing disclosure to the market.

²⁹ See section on *Market Surveillance* in Chapter 2.

The objective is to analyse the price and volume movements of both the above groups, as this provides a comparison between those stocks where the undisclosed information is potentially price sensitive, and those where the undisclosed information is likely to be purely technical. In addition to statistical analyses of the stock's market performance, both before and after a query notice has been sent, the company's reply to ASX is classified according to potential reliance on the listing rule exemptions to disclosure. The results suggest that in some sectors of the total sample, there has been a failure to provide material price sensitive information and this has been accompanied by a failure to maintain confidentiality of the information within the company.

The argument adopted is that s1001A/674 has contributed little to the previous standard of continuous disclosure as many companies are relying on 'carve-outs' to the regulation to avoid commitment to the higher standard of disclosure required by the statutory provision. For example, under listing rule 3.1, a company whose securities are quoted on ASX need not disclose information that relates to an incomplete proposal or negotiation. Other legitimate reasons for non-disclosure occur if the information is considered to be a trade secret, and disclosure might harm the company's competitiveness, or if the information is being generated for internal management purposes only.

In these instances, management maintains that certain material information should not be released as any public disclosure could damage the company's prospects. Many would also argue that the continuous disclosure provision should be interpreted to permit officers of a company to maintain confidentiality of material information when it is necessary to maximise the value of the corporation. This exemption would recognise the company's intellectual property rights in the information.³⁰

In listing rule 3.1, ASX states that if a company is relying on one of the 'carve-outs' to escape disclosure, then it must maintain absolute confidentiality of the information. However, if the company does not disclose, but also does not maintain this confidentiality, then s1001A/674 could be considered ineffective in its aim of maintaining an informed market. While there have been some

³⁰ Whincop M 'Towards a Property Rights and Market Microstructure Theory of Insider Trading Regulation - The Case of Primary Securities Market Transactions' (1996) 7 *Journal of Banking and Finance Law and Practice* 212-232 at 231.

well publicised instances of non-disclosure,³¹ there has been no criminal prosecution for a breach of the continuous disclosure provision.³²

A breach of confidentiality can lead to a possible contravention of s1002G/1043A, which prohibits insider trading. This provision carries a much higher pecuniary penalty than s1001A/674 but a similar maximum prison term. The drafting similarities between the insider trading and the continuous disclosure provisions are not coincidental. They are aspects of the same issue; non-disclosure can lead to insider trading, while full and timely disclosure would eliminate insider trading. Alternatively, by invoking the efficient market hypothesis,³³ which states that the prices of securities fully reflect available information, insider trading might be seen to provide a degree of indirect market disclosure in instances where there is no official disclosure by the company.

Section 1002G/1043A was inserted into the *Corporations Act*, effective 1 August 1991, to extend the scope of the provision beyond those who were 'connected with' the body corporate of the traded securities. The *Financial Services Reform Act*, as discussed in Chapter 5, amends the insider trading provision, and the proximity of the continuous disclosure and insider trading provisions.

Assuming that the failure by a listed company to disclose material information and to maintain confidentiality of the information within the company is related to the ineffectiveness of s1001A/674, then this study will attempt to isolate these elements. To isolate the first element, the study assumes that there has been a suspected failure to disclose in the case of those companies that ASX has queried for non-disclosure. The analysis entails examination of 427 instances where ASX has queried a listed company for non-disclosure.

It is more difficult to isolate the second element, a company's failure to maintain confidentiality. An indication of this breakdown of confidentiality might come from the trading pattern of the company's shares, from changes in price and volume. Even then, there is no procedure to distinguish whether a trading pattern is the result of an 'astute investor' who has speculated correctly, or an insider who is

³¹ There was considerable media publicity for continuous disclosure issues associated with Hudson Conway Limited and Crown Limited (Crown Casino) in 1997, The Broken Hill Proprietary Company Limited in 1996 and WMC Limited in 2001.

³² Longo J 'Market Misconduct Provisions of the Financial Services Reform Act: Challenges for Market Regulation' *Paper Presented at Centre for Corporate Law and Securities Regulation Seminar on Market Misconduct and the Financial Services Reform Bill* 8 October 2001, 1-42 at 41.

³³ See section on *Efficient Market Theory* in Chapter 3.

trading on leaked information. Nevertheless, the study isolates queries where the trading that prompted the ASX query could have been initiated by leaked confidential information.

It can be argued that the information, or the fact that some material information exists, will be recognised by observers as soon as the holder of the confidential information places a market bid or offer. For example, in the Simon Hannes insider trading case,³⁴ it was a trade in the call options of TNT Limited that alerted ASX's surveillance system to a potential insider trade and the subsequent disclosure of a takeover offer. ASIC was notified and further investigation led to Hannes' initial conviction for insider trading.³⁵

This insider trade signalled the potential existence of material information concerning TNT, even though market watchers were unaware of the content of the information. While it is possible for insiders to earn abnormal short-term profits, an efficient market will quickly evaluate and absorb the relevance of any price and volume movements associated with the undisclosed information.

Significance of the Research

Section 148A was inserted into the *Australian Securities and Investments Commission Act 1989* (Cth), effective 5 September 1994, at the same time as the *Corporations Act* was amended to accommodate the continuous disclosure provision. The ASIC Act stipulates that the Minister must seek advice from CASAC on the 'effectiveness' of continuous disclosure as outlined by s1001A/674. Accordingly, in May 1996, the Minister requested a report from CASAC on the effectiveness of continuous disclosure and related enforcement provisions. The review would also evaluate three provisions of the *Corporations Act* that were amended at the commencement of the ED regime:

- s776(1)/792D(1) a securities exchange to provide assistance to ASIC
- s777(1)/793C the power of the Court to enforce the business rules or listing rules of a securities exchange
- s779/1100A, 1100B qualified privilege for a securities exchange.³⁶

Periodic reporting was excluded from the terms of reference of the CASAC inquiry but it was included in the studies provided in Appendices 6 to 9 of the report.³⁷ Philip Brown, Professor of

³⁴ See section on *Insider Trading Case Law* in Chapter 5.

³⁵ This case is discussed in the section on *Insider Trading Case Law* in Chapter 5.

³⁶ CASAC (1996), note 26 at 1.

Accounting and Finance at the University of Western Australia and a member of CASAC, and Professors Terry Walter and Stephen Taylor of the Department of Accounting at the University of Sydney undertook these studies.

The studies were based on ASX's company announcements and share price data held at the University of Sydney. Announcements for release to the market are submitted electronically or by fax to the ASX company announcements office.³⁸ All disclosures are perused prior to deciding whether a temporary trading halt³⁹ in the securities is required under *ASX Business Rules* to enable a price sensitive announcement to be assessed by the market. A brief 'header' of the announcement is displayed on the trading terminals and, if the release is considered market sensitive, a 'voicemail' summary is broadcast to brokers and other subscribers.⁴⁰ The announcement is stored electronically and is made available to ASIC and to information vendors. The electronic text of these announcements is then compiled as Signal G⁴¹ and transmitted to selected subscribers and users of this ASX service.

The studies by Brown *et al* examined the impact of the ED regime on the disclosure policies of listed companies.⁴² The objective was to reveal the effect of continuous disclosure on the informational efficiency of the Australian share market.⁴³ In conclusion, Brown *et al* found tentatively that there was:

“...not strong evidence that the implementation of ED had any significant impact on the efficiency of the Australian share market nor indeed on the disclosure policies of these firms”.⁴⁴

³⁷ Ibid, Appendices 6-9.

³⁸ *ASX Listing Rules* Guidance Note 14 Company Announcements Platform (CAP) September 2001 par 2; ASX listing rule 15.3.

³⁹ See section on *Trading Halt* in Chapter 3.

⁴⁰ *ASX Listing Rules* Guidance Note 14 Company Announcements Platform (CAP) September 2001 pars 14-16.

⁴¹ The Securities Industry Research Centre of Asia-Pacific (SIRCA) holds these records of Signal G as a result of its research links with ASX.

⁴² CASAC (1996), note 26 Appendix 8.

⁴³ Ibid, Appendix 9.

⁴⁴ Ibid, Appendix 6 Executive Summary at 4.

A limited time period since the introduction of the legislation disadvantaged more definite results. The case study approach adopted in Appendix 8 of the CASAC (1996) report⁴⁵ was again limited. It was based largely on page counts. Five listed companies were randomly selected for more detailed analysis. Because the volume of the announcements released by these companies was extensive, the Signal G database was searched electronically. The quantity of disclosed information was measured by word, line and page count for each company.

The study by Brown *et al* was undertaken for ASIC and CASAC by the Securities Industry Research Centre of Asia-Pacific (SIRCA). Findings are summarised in the main body of the CASAC report and more detailed results are found in Appendices 6-9 of the report. In summary, the SIRCA study found that the continuous disclosure regime:

- appeared to have made little difference to the disclosure patterns of larger listed companies that already complied with the previous ASX listing rule 3A(1);
- appeared to have encouraged smaller listed companies to publicly release some additional price sensitive information, which consisted mainly of ‘bad news’ items;
- indicated that an increase in forward looking and voluntary disclosures could have resulted from contemporary changes in general economic conditions.

The overall results of the study failed to reveal any strong evidence that implementation of a statutory backed continuous disclosure regime had significantly altered the efficiency of the market or the disclosure policies of listed companies.⁴⁶ A contemporaneous survey of listed disclosing entities supported the Brown *et al* findings. It showed that two thirds of the respondents did not significantly increase the number of separate items disclosed by their companies after September 1994, compared with prior periods. Also, 80 per cent of respondents stated that the content of their companies’ disclosures had not changed since the introduction of the continuous disclosure regime. This opinion was based on a sample of 70 replies to over 300 questionnaires distributed to ASX listed companies.⁴⁷

⁴⁵ Ibid, Appendix 8 at 11.

⁴⁶ Ibid, Appendix 8 at 9-10.

⁴⁷ Ibid, Appendix 3 at 1, 7.

A more recent 1999 survey⁴⁸ received 96 responses to questionnaires sent to 110 directors of ASX listed companies. In contrast to the earlier survey, 80 per cent of respondents expressed the view that continuous disclosure played an important role in improving the integrity of Australian capital markets.⁴⁹ Overall, the latter study found that the regime achieved a more informed market by offering managers ‘strong disincentives to engage in practices of non-disclosure, late-disclosure and selective disclosure’.⁵⁰ Although indicative of the growing persuasiveness of continuous disclosure, the results of neither survey can be considered conclusive due to the small samples and lack of comprehensiveness across all sizes of listed companies.

⁴⁸ Corlett H, R da Silva Rosa and T Walter *Corporate Executives’ Experience of Continuous Disclosure* Monograph No 9 The Accounting Foundation University of Sydney 2000 1-188 at 12, 13.

⁴⁹ *Ibid*, at 14. These views were expressed in 1999 and followed a period of considerable media publicity for continuous disclosure issues, see note 31.

⁵⁰ *Ibid*, at 152.

CHAPTER 2

Introduction to Continuous Disclosure

In November 1991, the House of Representatives Standing Committee on Legal and Constitutional Affairs released a report entitled *Corporate Practices and the Rights of Shareholders*.⁵¹ To be known as the ‘Lavarch Report’, the Committee in 1990 had interviewed more than 50 witnesses from the leading accounting, securities and legal firms and organisations. As a result of these interviews, the Attorney General made a recommendation to the Federal Government in November 1991 that a regime of ‘continuous disclosure’ by listed companies should be ‘introduced, implemented and enforced through the *ASX Listing Rules*’.⁵²

CASAC’s 1991 *Report on an Enhanced Statutory Disclosure System*, stated that a system of continuous disclosure, strengthened by statute, would promote investor confidence, which was perceived to be at a low point following the 1987 market crisis. CASAC presumed a lack of informational efficiency as market forces failed ‘to guarantee adequate and timely disclosure by disclosing entities’.⁵³ Such information, if disclosed:

- would lessen the possible distorting effects of rumour on a company’s share price, and
- minimise opportunities for insider trading and other market abuses.⁵⁴

CASAC was subsequently required to report on the effectiveness of continuous disclosure.⁵⁵ Its 1996 *Report on Continuous Disclosure* outlines the role of ongoing corporate disclosure in the ED regime. This document is authoritative background to the relevant legislative provisions and provides insight into ASIC’s evaluation of the 1994 corporate law reforms. The complementary role of ASX listing rule 3.1 is essential to an evaluation of the disclosure provision. For this reason, its development is now discussed in detail.

⁵¹ Lavarch Report, note 1.

⁵² *Ibid*, at pxxii Recommendation 12.

⁵³ CASAC (1991), note 2 at 7.

⁵⁴ *Ibid*, at 7.

⁵⁵ ASIC Act s148A: the Minister must request the Advisory Committee to advise on the operation of the continuous disclosure provisions as soon as practical after the end of 18 months after the day of commencement of the provisions.

ASX Listing Rules

Although there were no listing rules, as we now know them, in existence in the 1890s, the stock exchange's application form, to be completed by a company requesting quotation of its securities, includes the condition that it must agree:

“...to give prompt notification of all calls, dividends, alteration of capital, or other material information”.⁵⁶

This last phrase appears to be the first example of an Australian listing requirement demanding continuous disclosure of material information by a company. It established the principle that there is a contractual obligation⁵⁷ for a listed company to release relevant information to the market on an ongoing basis. As such, it is an early forerunner of ASX listing rule 3A(1) and the present rule 3.1.

Under an earlier version of listing rule 3A(1), companies had long been required to notify the stock exchange immediately of:

“...any information concerning the company or its subsidiaries necessary to avoid the establishment of a false market in the company's securities or which would be likely to affect materially the price of those securities”.⁵⁸

The wording of listing rule 3A(1) was amended from 1 January 1992 to clarify the requirement for ‘immediate’ reporting and to include a test similar to that of the former s1022.⁵⁹ This test concerned the information to be included in a prospectus for the issuing of company securities. The provision required that a prospectus should:

⁵⁶ Salsbury S and K Sweeney *The Bull, the Bear and the Kangaroo: The History of the Sydney Stock Exchange* Sydney Allen & Unwin 1988 at 203.

⁵⁷ See section on *Contractual Obligation of the Listing Rules* in Chapter 5.

⁵⁸ Redmond P *Companies and Securities Law* Sydney Law Book Company 1st ed 1988 at 604; R Bruce, B McKern, I Pollard and M Skully eds *Handbook of Australian Corporate Finance* Sydney Butterworths 4th ed 1991 at 482.

⁵⁹ The *Corporate Law Economic Reform Program Act 1999* (Cth) (CLERPA) was effective from 13 March 2000. As a result of CLERPA, many of the provisions of the *Corporations Law* were amended or substituted. In the main discussion, reference is made to the pre-CLERPA provisions of the *Corporations Law*. The post-CLERPA section numbers are also provided in the main discussion, or in an accompanying footnote, whenever the section is first referred to in any new context. For example, s1022 has been substituted by CLERPA s710. Reference is now to the provisions of the *Corporations Act*. Source: *Corporate Law Economic Reform Program Act 1999* (Cth) Schedule 1 – Main Amendments to the Corporations Law.

“...contain all such information as investors and their professional advisers would reasonably require and reasonably expect to find in the prospectus, for the purpose of making an informed assessment...”⁶⁰

The general disclosure test of prospectus content in s710(1) of the *Corporations Act* now includes a similar test.

The rationale for this test was based on the nexus between prospectuses and secondary trading. The ASX proposed test, contained in paragraph (c) of listing rule 3A(1), would clarify the obligation of a listed company to notify the exchange immediately of:

“...any information which -

- (a) is likely materially to affect the price of the securities of the listed company;
- (b) is necessary to avoid the establishment or continuation of a false market in the company’s securities; or
- (c) investors and their professional advisers would reasonably require and reasonably expect to be disclosed to the market, for the purpose of making an informed assessment of -
 - (i) the assets and liabilities, financial position, profits and losses, and the prospects of the listed company; and
 - (ii) the rights attaching to securities of the listed company”⁶¹

In 1994, ASX prepared a discussion paper to seek the views of interested parties concerning further proposed amendments to listing rule 3A(1). It was the stock exchange’s stated intention to implement the amendments prior to the introduction, by the *Corporate Law Reform Act* 1994, of the continuous disclosure provisions.⁶² Comments were invited by 21 July 1994 on the following version of 3A(1):

“A listed company shall immediately notify the Exchange of –

- (1) any information of which it becomes aware that a reasonable person would expect to have a material effect on the price or value of securities of the company, unless:

⁶⁰ Formerly s1022(1) of the *Corporations Law*.

⁶¹ Australian Stock Exchange Limited ‘Proposed Listing Rule 3A(1) and a Guidance Note on the Operation of Listing Rule 3A(1) and Other Issues’ *ASX Discussion Paper: Listing Rule 3A(1)* 1994 at 2-4; Baxt *et al* (1993), note 9 at 183.

⁶² *Ibid*, *ASX Discussion Paper: Listing Rule 3A(1)* at 2.

- (a) disclosure of the information would result in detriment to the company that exceeds the benefit to the market of the disclosure or would result in a breach of a law; and
- (b) the information not disclosed is strictly confidential; and
- (c) within two business days of the company becoming aware of the information the board of the company ratifies the decision not to disclose it; and
- (d) the information not disclosed is notified to the Exchange immediately it does not satisfy the requirements of paragraphs (a), (b) or (c).

For the purpose of paragraph (a) the company shall have regard only to detriment that arises because the information is not reasonably certain or is only created or generated for the legitimate internal management purposes of the company.”⁶³

The stock exchange wished to bring to the attention of listed companies that they could not rely on confidentiality clauses in third party agreements to avoid a disclosure obligation. The following paragraph was offered for discussion:

“For the purpose of paragraph (a) the company shall not have regard to detriment that arises because of confidentiality by reason of a relevant agreement that contains confidentiality requirements or the effect of disclosure on the price or value of the company’s securities.”⁶⁴

There was little support for above paragraph as it was not mentioned in the proposed guidance notes, and it was not included in the final form of the rule or guidance notes. In this proposed new version of the rule, ASX also removed paragraph (c) of the January 1992 rules as the proposed 1994 reform to the *Corporations Act*:

“...breaks the nexus between prospectuses and secondary trading and introduces a test for disclosure on an ongoing basis for listed entities that is based on the Listing Rules in part”.⁶⁵

The proposed new rule also introduced the concept of a listed company becoming ‘aware’ of information that should be disclosed (above at (1)). In the proposed guidance note, ASX took the view that this obliged the company to ‘have an appropriate system in place to identify material

⁶³ Ibid, at 3.

⁶⁴ Ibid.

⁶⁵ Ibid, at 3, 4.

information and make a decision about its disclosure'.⁶⁶ This concept was retained and a definition of 'aware' was inserted into listing rule 19.2. The definition states that 'an entity becomes aware of information if 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 as a director or executive officer of that entity'.

ASX based this definition of 'aware' on s1002E/1042G, which defined 'Information in Possession of Officer or Body Corporate' for the purposes of insider trading. However, the definition in listing rule 19.2 is narrower, as ASX limits the test to directors and executive officers and 'does not extend to employees generally'.⁶⁷ Section 9 of the *Corporations Act* defines an 'executive officer' as a person who is concerned in, or takes part in, the management of the company. This secondary liability does not detract from the primary issue that 'compliance with listing rule 3.1 is the responsibility of the entity'.⁶⁸

ASX received 62 submissions to the discussion paper, circulated in July 1994, containing draft amendments to listing rule 3A(1). After consideration of these submissions, ASX inserted a 'reasonable person' condition to replace the 'detriment versus benefit' proposal in the discussion paper. It also abandoned requirements that confidentiality be 'strict' and the need for a board of directors to meet within two days if confidential information were to be withheld from the market.⁶⁹

The reaction of listed companies and other interested parties to the proposed legislative changes alerted ASX to a need to make provision for competitive trade information. The stock exchange recognised that companies may have the right to withhold confidential material.⁷⁰ At the time, listing rule 3A(1) made no provision for such a 'carve-out'.⁷¹

⁶⁶ Ibid, at 3, 12.

⁶⁷ *ASX Listing Rules* Guidance Note on Continuous Disclosure pars 5, 6 issued 1 July 1996.

⁶⁸ Ibid, at par 6.

⁶⁹ Butterworths (1994) 18 *Corporations Law Bulletin* at 476, 483.

⁷⁰ Corporate Law Reform Bill 1994 *Explanatory Memorandum* Summary of main features of the Bill par 21.

⁷¹ 'Carve-outs' or exemptions to the listing rule are discussed in greater detail in the next section of this chapter.

In order to encourage timely disclosure, the old ASX listing rule 3A(1) requested the listed company to supply the exchange ‘immediately’ with information that was likely to materially affect the price of its shares. A listed company was previously defined by ASX as ‘a company which has been admitted to the Official List of Australian Stock Exchange Limited’.⁷²

The revised listing rule 3.1 no longer states that it is a ‘listed company’ that must notify the stock exchange.⁷³ Instead, accommodating the wording of s1001A/674, the rule specifies that an ‘entity must immediately tell the ASX...’. This brought listing rule 3.1 into line with the provision but it necessitated changes to ASX definitions of ‘entity’. In the 1995 edition of the listing rules:

“Entity means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives.”⁷⁴

Following the July 1996 simplification of the rules, the definition of a ‘listed company’ was removed and the definition of an ‘entity’ was further amended to read:

“an entity that has applied for admission to, or is admitted to, the Official List”.⁷⁵

‘Carve-Outs’

A ‘carve-out’ is jargon for the act of cutting out a part or a segment from a larger whole. While the term is not used in the legislation or the listing rules, it is constantly employed in the CASAC (1996) *Report on Continuous Disclosure* in reference to an exemption to listing rule 3.1. In the context of these exemptions the phrase has become accepted within the securities industry.

Prior to 1994, there was no express ‘carve-out’ in the ASX disclosure rule, only a test of ‘reasonableness’ in paragraph (c) of the 1992 version.⁷⁶ The *Explanatory Memorandum* to the Corporate Law Reform Bill 1994 recognised the possible necessity of regulating ‘to enable confidential information to be excluded from disclosure under the proposed continuous disclosure

⁷² *ASX Listing Rules* Definitions 1 October 1995 at 0.8.

⁷³ CCH Australia Limited *Former ASX Listing Rules* 1996.

⁷⁴ *ASX Listing Rules* Definitions 1 October 1995 at 0.7.

⁷⁵ *ASX Listing Rules* Chapter 19 Interpretation and Definitions at 1908.

⁷⁶ *ASX Discussion Paper: Listing Rule 3A(1)*, note 61 at 3.

requirements'. However, in the case of listed companies, the regulator was prepared to defer this responsibility as ASX was:

“...considering the possibility of amending Listing Rule 3A(1), relating to continuous disclosure, to include the right to withhold confidential material - a matter presently not expressly provided for in the Rule”.⁷⁷

The 1994 proposed listing rule would allow the first rudimentary ‘carve-outs’, if the information was not reasonably certain, if it was for internal management purposes or if it would result in a breach of the law. These exemptions were retained to form the current listing rules 3.1.3 (c), (d) and (a) respectively. The need for the board of a company to ratify a non-disclosure decision within two business days was replaced in the final version with (e), the trade secret exemption, and (b), an exemption for information concerning an incomplete proposal or negotiation. The ‘reasonable person’ test and the confidentiality requirement were retained from the proposed rule but, as previously mentioned, the necessity for information to be ‘strictly’ confidential was ignored.⁷⁸

ASX listing rule 3A(1), now 3.1, was subsequently amended to allow the six ‘carve-outs’ to the rule to be effective from the introduction of s1001A/674 in 1994. The following exemptions (3.1.3) apply, if a reasonable person would not expect the information to be disclosed (3.1.1) and the information is confidential (3.1.2):

- (a) It would be a breach of the law to disclose the information.
- (b) The information concerns an incomplete proposal or negotiation.
- (c) The information comprises matters of supposition or is insufficiently definite to warrant disclosure.
- (d) The information is generated for the internal management purposes of the entity.
- (e) The information is a trade secret.⁷⁹

Chapter 23 of the *Listing Rules Simplification*⁸⁰ draft was devoted to continuous disclosure and it offered for public discussion and comment, by 13 October 1995, a further amended version of rule

⁷⁷ Corporate Law Reform Bill, note 70 at 133.

⁷⁸ Although no specific reasons were given, it seems likely that ‘strictly’ was considered too stringent a requirement or that this wording could imply ‘strict liability’.

⁷⁹ See Appendix 2 for ASX listing rule 3.1.

⁸⁰ Australian Stock Exchange Limited *Listing Rules Simplification* Exposure Draft August 1995 at 4-6.

3A(1). ASX proposed that these amendments would be effective 1 July 1996 as the renumbered listing rule 3.1. The proposed revision was to include the phrase ‘and is in fact confidential’ after each of the four exemptions (b) to (e). This rephrasing was intended to replace the existing placement of the word ‘confidential’, which appeared once only prior to the list of ‘carve-outs’. ASX did not proceed with this amendment. The other revision, which was effected from 1 July 1996, was the transference of the definition of ‘aware’ to Chapter 19 of the listing rules on interpretation and definition.⁸¹

As the ‘carve-outs’ are included in the ASX listing rules rather than the legislation, then it follows that there are no specific exemptions available to s1001B/675, which applies to unlisted and other disclosing entities. However, the CASAC (1996) report recommended that unlisted disclosing entities should, when necessary, have access to the same ‘carve-out’ exemptions as listed entities.⁸²

Also, s111AT enables ASIC to grant exemptions to all or specified disclosing entity provisions. This would provide non-listed entities, as well as those that are listed, with relief from disclosure of confidential or unreasonably prejudicial information. The Commission may impose conditions on any exemptions, but these exemptions cannot be treated lightly.⁸³ Any intentional or reckless breach of a condition imposed pursuant to any relief granted by ASIC is an offence and, on application, the Court may order compliance with the condition.⁸⁴

The survey in Appendix 3 of the *Report on Continuous Disclosure* is of relevance to the empirical aspects of this thesis. The results indicated that approximately a third of all respondents to the CASAC (1996) inquiry acknowledged that they relied on ‘carve-outs’ to listing rule 3.1 and, in particular, the exemption for incomplete proposals or negotiations.⁸⁵

A number of respondents still had doubts on the correct application of the ‘carve-outs’. For example, a joint venture arrangement is incomplete until the signing of the agreement, but the parties could have accepted letters of intent and a memorandum of understanding over an extended period prior to

⁸¹ ASX listing rule 19.12.

⁸² CASAC (1996), note 26 Appendix 1 Recommendation 10.

⁸³ Ibid, at 14 and n32; *ASIC Policy Statements ‘Disclosing Entity Provisions Relief’* PS95 par 95.49(b).

⁸⁴ Ibid, at 16 and n43 s111AU and Schedule 3.

⁸⁵ Ibid, Appendix 3 at 7 par 16.

the legally binding agreement. Indecision on the timing of disclosure is still an issue. Other issues of concern to the respondents relate to maintaining confidentiality during the course of negotiations over a contract. Information will, of necessity, become available at this time to a third party such as a legal or financial adviser.⁸⁶

Periodic Disclosure

The 1994 *Corporate Law Reform Act* effected more stringent periodic or regular reporting for listed companies. Periodic reporting now required disclosure at specific intervals throughout the year. As part of the ED regime, a provision demanding the lodgment of accounts by companies that are disclosing entities was introduced by s317A(1).⁸⁷ The legislation recommended:

- half-yearly statements to be audited or reviewed,
- wider disclosure in both half-yearly and final financial statements submitted to ASIC,
- expanded pro forma half-yearly and preliminary final reports submitted to ASX.

Section 317A(1), inserted into the *Corporations Act* as part of ED and effective 1 July 1994, required disclosing entities to lodge with ASIC financial statements for the accounting period (s111AO).⁸⁸ Under the current legislation, a disclosing entity must lodge financial reports for the half-year (s320) as well as the full financial year (s319).⁸⁹ A copy should also be given to ASX as this disclosure to ASIC is considered ‘material’ under s1001D/677 and listing rule 3.1.

More specifically, copies of half-yearly and annual financial statements supplied to ASIC by listed companies must be lodged with ASX under listing rules 4.2 and 4.5.⁹⁰ In addition, ASX still requires pro forma half-yearly and preliminary final statements, and the listed company’s annual report, to be sent to ASX under listing rules 4.1, 4.3 and 4.7 respectively.⁹¹ Both statements are pro forma, in

⁸⁶ Ibid, Appendix 3 at 5, 6 par 12.

⁸⁷ Substituted by ss319-323DA effective 1 July 1998.

⁸⁸ Section 111AO was amended to refer to accounting requirements in Chapter 2M effective 1 July 1998.

⁸⁹ Sections 317A(1) and 50A(2) substituted by ss319-323DA effective 1 July 1998.

⁹⁰ ASX listing rule 4.5 states that if an entity is required to comply with the *Corporations Act* in relation to the lodgement of annual financial statements, it must give ASX a copy of the documents that it lodges with ASIC under the *Corporations Act* no later than the time that it lodges them. Listing rule 4.2 refers in similar terms to the lodgement of a half-yearly statement with ASX.

⁹¹ ASX listing rule 4.3 states that following the end of the financial year of an entity (except a mining exploration entity, Appendix 5B), the entity must complete Appendix 4B (preliminary final report)

accordance with Appendix 4B of the listing rules, and must be submitted to the stock exchange within 75 days. The market continues to receive its most timely indicator of a company's year-end financial position through the pro forma preliminary final statement rather than the annual report financial statements.

A listed company has a deadline of 17 weeks after the close of its financial year during which time it must distribute the annual report to shareholders and ASX (listing rules 4.6, 4.7). These published annual accounts, submitted to both regulators and to shareholders, are expected to contain additional disclosures, particularly in the area of corporate governance. This is not prescribed by legislation but ASX listing rules encourage disclosure of corporate governance matters. For example, while listing rule 4.10.2 does not require the formation of an audit committee, when this is absent the company must give the reason.

The company must provide a statement of its main corporate governance practices (listing rule 4.10.3) and an indicative list of these is given in Guidance Note 9 Disclosure of Corporate Governance Practices of the listing rules. The company is asked to tell the stock exchange if it has formed a nomination committee or a remuneration committee. Suggestions have also been made that a disclosure committee could be added to this list to co-ordinate disclosure and compliance under ASX listing rule 3.1.

As discussed previously, and contrary to persuasive international precedent, the ED regime excluded quarterly reports as a form of regulatory control for all companies. There has always been a strong resistance from the corporate sector to the cost of complying with periodic quarterly reporting and this attitude probably influenced the initial decision by the regulators.⁹² This decision is contrary to the disclosure models in Canada and the United States (US) discussed in Chapter 4⁹³ where listed companies are expected to prepare quarterly reports. It is a decision that is also contrary to the findings of some studies, which argue that increasing reliance on continuous disclosure has been at

and give it to ASX. Listing rule 4.1 refers in similar terms to the completion of Appendix 4B at the end of the half-year. Listing rule 4.7 states that at the time it sends the annual report to security holders, the entity must tell ASX that it has sent the documents and give ASX a copy of the annual report.

⁹² CASAC (1996), note 26 Appendix 3 at 15-16.

⁹³ See sections on *United States* and *Canada* in Chapter 4.

the expense of a more structured framework of quarterly reporting and management discussion and analysis statements.⁹⁴

However, there are quarterly reporting requirements for companies with mining production and exploration activities and these are contained in Chapter 5 of the *ASX Listing Rules*. Listing rules 5.1 to 5.3 state that a mining company must complete a report and give it to ASX within one month after the end of each quarter of its financial year. Previously, there were listing rules specifically designed for the immediate reporting of significant petroleum exploration test results (listing rule 5.4) and weekly reporting of petroleum exploration results (listing rule 5.5).

These last two rules were deleted from 1 July 1998, as listing rule 3.1 was considered sufficient to ensure timely disclosure of oil and gas exploration activities. The rules were removed because many exploration companies were constrained by these ‘immediate’ and weekly reports to disclose commercially valuable information even if ‘it was not information that a reasonable person would expect to have a material effect on the price or value of the securities...’.⁹⁵ If the exploration results are information that a reasonable person would expect to have a material effect on the price of the company’s shares then the information must be disclosed under listing rule 3.1.

In contrast, ASX introduced listing rule 4.7B from 31 March 2000. This rule requires an entity, which is admitted to the Official List under the ‘commitments’ assets test in listing rule 1.3.2(b), to provide Appendix 4C quarterly cash flow reports to ASX. The ‘commitments’ test is applicable if half or more of the company’s total tangible assets are cash, or easily convertible to cash, and the company is committed to spend these assets in accord with a clearly stated business objective and expenditure program. Listing rule 4.7B also provides that an Appendix 4C quarterly cash flow report may be requested by ASX, particularly if there is a proposed change to the nature or scale of the company’s activities as stated in listing rule 11.1.3.

At 30 June 2001, over 200 listed entities were required to submit quarterly cash flow reports in addition to periodic reporting and continuous disclosure obligations.⁹⁶ Many of these are ‘new

⁹⁴ Gallery G and C Gilchrist ‘Preemptive Announcements of Earnings Changes: Continuous or Selective Disclosure?’ *Corporate Disclosure Summer School* University of Sydney Accounting Foundation and School of Accounting, University of Technology Sydney February 1998 at 25. See also the later section on *Management Discussion and Analysis*.

⁹⁵ *ASX Listing Rules* Guidance Note on Continuous Disclosure par 33, 34 issued 16 November 1998.

⁹⁶ Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 29.

economy companies' that need to be reminded 'that the requirement to lodge quarterly cash flow statements to the ASX does not in itself satisfy their continuous disclosure obligations'.⁹⁷

Resistance to periodic quarterly reporting is still evident in the Australian corporate sector. As an incidental aspect of the inquiry into the effectiveness of continuous disclosure, CASAC sought the views of listed companies on quarterly reporting. Sixty per cent of respondents opposed any introduction of quarterly reporting for all companies. The basis of this response was a feared overload of information for investors if it was introduced in addition to existing half-yearly statements, annual reports and continuous disclosure. Respondents argued that a focus on short-term quarterly results would be to the detriment of a company's longer-term performance, particularly if seasonal or cyclical factors were involved. The respondents indicated that quarterly reporting would not only be more time consuming but would impose significant costs on the company. Even if it were not mandatory to audit quarterly reports, there would still be increased audit costs. The increased exposure of directors to potential liability would necessitate at least an audit review of any quarterly reports that were publicly disclosed.⁹⁸

Statutory Continuous Disclosure

Concurrent with the demands for expanded periodic reports, s1001A/674 requires continuous disclosure of information that would be expected to have a 'material effect' on a company's share price. The degree of compliance with this mandatory, but discretionary, continuous disclosure requirement is more difficult to evaluate. Mandatory, in the sense that the law demands it, but discretionary to the extent that (i) a company's management can choose the timing of the disclosure, and (ii) the company can also choose to rely on one of the 'carve-outs'. It follows that if the discretionary element is improperly exercised it can impinge on the effectiveness of the regulation.

CASAC initially took the view that immediate disclosure placed too heavy a burden on the company and this could result in unreliable information. CASAC proposed a two step system of disclosure where management could 'as soon as it is practicable', or at least within 24 hours, lodge with ASIC either a press release outline of the material matter or a completed statement of the material matter.

⁹⁷ ASIC Media Release 'ASIC Cracks Down on Continuous Disclosure' 01/284 13 August 2001.

⁹⁸ CASAC (1996), note 26 Appendix 3 at 15-16.

Alternatively, if only the outline was provided, then a full statement must be lodged with ASIC within the next two business days.⁹⁹

The final 1994 legislative amendment was a compromise between the two attitudes to timely disclosure. The proposed two step disclosure system was discarded and s1001A(1)(b)/674(1) now requests the company to notify the securities exchange about matters ‘as they arise’. The ASX listing rule continues to require an entity to convey the information ‘immediately’, but the ‘carve-outs’ can provide an alternative.

An amended s776(1)/792D(1), which requires ASX to provide assistance to ASIC, was effective from 4 September 1994 to complement the ED legislation. If information is provided to ASX by a listed disclosing entity, and ASX releases that information to the stock market, then as soon as practicable the stock exchange must provide ASIC with a copy of the document (s776(2B)/792C(1)), unless the regulations provide otherwise (s776(2C)/792C(2)).

CASAC (1996) also outlines disadvantages that could arise from the statutory disclosure procedure. Some critics argue that any increase in disclosure, whether quarterly or continuous, will add to a company’s administrative costs and overload the market with unimportant information. Also, premature disclosure by companies can cause, rather than overcome, misinformation in the market. An ASX query to a company in reaction to rumour or press speculation could result in premature release of information and disadvantage the parties concerned.¹⁰⁰

Management Discussion and Analysis

In the spirit of continuous disclosure, the Corporate Law Simplification Task Force recommended the inclusion of management discussion and analysis (MD&A) as part of Australia’s corporate disclosure regime. The task force responded to criticism that most annual financial disclosure requirements encouraged a checklist approach by directors, rather than presenting information of interest to shareholders.¹⁰¹

⁹⁹ CASAC (1991), note 2 at 11, 23.

¹⁰⁰ CASAC (1996), note 26 Appendix 3 at 13.

¹⁰¹ Securities Institute of Australia ‘MD&A Crucial for Reporting Standards’ (1998) 4 *JASSA* 32.

The requirement for a MD&A statement was introduced in the Second Corporate Law Simplification Bill, released for comment in June 1995. When the Corporate Law Review Bill replaced the Second Simplification Bill, the requirement for a MD&A was deleted. The securities industry has since encouraged ASX to incorporate a MD&A requirement as part of the corporate governance matters requested under Chapter 4 of the listing rules. The Securities Institute suggests that additional MD&A disclosure is in keeping with standards in other major capital markets and would increase Australia's standing as a competitive market place.¹⁰²

Although not included as a listing rule, ASX did introduce Guidance Note 10 on Review of Operations and Activities from 1 September 1999.¹⁰³ Listing rule 4.10.17 states that an entity must include a review of its operations and activities in its annual report. While ASX does not require the review to follow any particular format, it does support the Group of 100 Incorporated publication 'Guide to Review of Operations and Financial Condition'. A copy of this Guide, which encompasses many areas of discussion found in a MD&A disclosure, is included as an Attachment to ASX Guidance Note 10.

Electronic Disclosure

ASIC is increasingly conscious of the need to include electronic information in its policy decisions. These policies are relevant to the regulation of continuous disclosure. In November 1996, a Parliamentary Joint Committee on Corporations and Securities submitted recommendations for the Draft Second Corporate Law Simplification Bill 1996.¹⁰⁴ In relation to disclosure, the Committee recognised ongoing problems for regulatory bodies associated with the internationalisation of stock markets.

The recommendations support mandatory disclosure to ASX by those Australian listed companies based in foreign jurisdictions. Greater disclosure of a company's corporate governance and remuneration policies is recommended, including remuneration packages of offshore, as well as domestic, directors. In addition, the role of electronic communication is recognised in the Bill.¹⁰⁵ Globalisation and diminishing technical barriers increase access by investors to alternative securities

¹⁰² Ibid.

¹⁰³ *ASX Listing Rules* Guidance Note 10 Review of Operations and Activities September 2001.

¹⁰⁴ CCH Australia Limited *Australian Corporations and Securities Law Reporter* 1996 601-861.

¹⁰⁵ Ibid, at 601-855.

products via the Internet.¹⁰⁶ This wider arena places regulators under pressure from both the retail and institutional sectors of the securities industry to adapt to the new environment.

The former ASIC Chairman, Alan Cameron, acknowledged that an appropriate regulatory framework was required as jurisdictional barriers were dissolved on the 'information superhighway'. A central issue is the control of securities information. Is domestic regulation adequate or is international cooperation required? Cameron noted that care must be taken not to inhibit opportunities offered through the electronic medium by mandating 'regulation based on the assumptions of the paper world'.¹⁰⁷ The approach taken by ASIC is to continue to educate and alert investors to the risks associated with using potentially unreliable securities information that is found on the Internet.

At a local level, brokers use the Internet as a cost effective method of disseminating information to clients and potential clients.¹⁰⁸ The 'regulators are looking to more "decentred" regulatory techniques'¹⁰⁹ to accommodate this electronic information and online investment. ASIC has adapted a number of existing policies to the electronic environment.¹¹⁰ For example, relief from existing requirements could enable accurate electronic prospectuses and application forms to be issued on the Internet, with the proviso that a hard copy prospectus was submitted to ASIC and a free paper copy should also be made available to investors on request.¹¹¹ Subsequently, relief was granted to issuers of electronic prospectuses and intermediaries who distributed these prospectuses online. This exemption was extended to those who established a website to host third party prospectuses.¹¹² ASIC has also agreed with other international regulators on policies concerning offers that appear on the

¹⁰⁶ Sucher R 'The Internet and the Securities Industry' (1996) 1st Quarter *ASX Perspective* at 54.

¹⁰⁷ Butterworths 'Internet Threat: Cameron Sees Electronic Commerce Challenge' (1997) 3 *Corporations Law Bulletin* at 5.

¹⁰⁸ Sucher, note 106 at 55.

¹⁰⁹ Examples include: 'codes of conduct, self regulatory techniques, voluntary disclosure, investor education and even standard setting by the market': D Kingsford Smith 'Decentred Regulation in Online Investment' (2001) 19 *Company and Securities Law Journal* 532-549 at 532.

¹¹⁰ Australian Securities Commission *Electronic Prospectus Draft Policy Statement* 6 May 1996 at 2, 3; *ASC Electronic Commerce Policy - Issues Paper* August 1995; *Background Information Paper - Electronic Commerce in the Financial Service Industry: Challenges and Opportunities* 6 May 1996.

¹¹¹ *ASIC Policy Statements* 'Electronic Prospectuses' PS107 18 September 1996, updated 10 February 2000, at 107.45, 107.76.

¹¹² *ASIC Information Release* 'ASIC Provides Innovative Internet Relief' 99/021 2 July 1999.

Internet and can be accessed by investors in Australia. This cooperation is conducted through the Internet Taskforce of the International Organisation of Securities Commissions (IOSCO).¹¹³

To encourage discourse on the regulatory challenges posed by multi-media prospectuses and other offer documents, ASIC released an issues paper in December 1999, in conjunction with the Centre for Corporate Law and Securities Regulation.¹¹⁴ At the same time, the Centre and Dr Elizabeth Boros also issued a complementary discussion paper and questionnaire on electronic corporate communications.¹¹⁵ Availability of information on a corporate website can improve accessibility to retail investors but time and skill are necessary for meaningful analysis of this information.¹¹⁶ In the context of continuous disclosure, this increased availability does not alter the fact that it is the timing of the disclosure that is most crucial.

In November 1999, ASIC issued guidelines restricting any selective disclosure made by companies to securities analysts. ASIC presented the guidelines as a discussion paper entitled 'Heard it on the Grapevine...'.¹¹⁷ The regulator suggests that to minimise opportunities for insider trading, listed companies should adopt practices that provide greater disclosure to an increasing number of private investors. Such practices could include notification to ASX of any analysts' briefings, live Internet broadcasts of these briefings and placing transcripts and summaries of briefings on the company's website.¹¹⁸ One recommended measure for achieving good corporate disclosure is establishing a

¹¹³ *ASIC Policy Statements* 'Offers of Securities on the Internet' PS141 10 February 1999, updated 2 March 2000, at 141.5 and 141.29; Australian Securities and Investments Commission 'Regulatory Initiatives by ASIC in the Cyber Age' A presentation by Jillian Segal, Deputy Chair of ASIC, to the Faculty of Law, University of Sydney *Financial Markets and the Internet Conference* Sydney 31 May 2001 1-13 at 4; Segal J 'Managing the Transition to the Cyber World' (2001) 19 *Company and Securities Law Journal* 519-531 at 523.

¹¹⁴ *ASIC Media Release* 'ASIC Tackles Issue of the Multi-Media Prospectus' 99/452 7 December 1999; Australian Securities and Investments Commission and Centre for Corporate Law and Securities Regulation 'Multimedia Prospectuses and other Offer Documents' Issues paper written by Dr Elizabeth Boros December 1999 1-17.

¹¹⁵ Centre for Corporate Law and Securities Regulation 'The Online Corporation: Electronic Corporate Communications' Discussion paper written by Dr Elizabeth Boros December 1999 1-37.

¹¹⁶ Boros E 'Corporations Online' (2001) 19 *Company and Securities Law Journal* 492-504 at 493.

¹¹⁷ Australian Securities and Investments Commission 'Heard it on the Grapevine...' *Draft ASIC Guidance and Discussion Paper* November 1999 1-28.

¹¹⁸ *Ibid*, Part 4 pars 33-62.

company website. Examples of electronic corporate disclosure in the US, United Kingdom and Canada are included with the discussion paper to support this recommendation.¹¹⁹

ASIC's later guidance principles, 'Better Disclosure for Investors',¹²⁰ again suggests the use of technology as a practical way for a company to give investors better access to information and prevent selective disclosure. In turn, these guidance rules are incorporated, with comment, into ASX's revised guidance note on continuous disclosure. ASX recommends that as 'minimum best practice' all relevant information, including analysts' briefings, should be placed on the company's website following full disclosure to the stock exchange.¹²¹

A considerable number of publicly listed companies already maintain websites to provide information to shareholders, potential investors and clients. The stock exchange supports electronic dissemination by the companies of all releases presently made to ASIC and to ASX but it is not a specific requirement. The Managing Director of ASX foresees that in the future all corporate disclosure could be made by way of a company's website, to avoid the current practice of the stock exchange rescanning non-electronic material before announcement.¹²²

Some companies have placed advertisements in the financial press notifying the public of an 'open briefing' that will be released immediately to ASX's company announcements platform. Interested parties are able to register electronically for notification of future briefings. These advertisements may be published in association with ASX and under the ASX logo.¹²³

¹¹⁹ Ibid, Appendix B at 26.

¹²⁰ Australian Securities and Investments Commission 'Better Disclosure for Investors' *Guidance Rules* 23 August 2000 par 2; *ASIC Media Release* 'ASIC & ASX Join Forces for Better Disclosure by Listed Companies' 00/365 23 August 2000.

¹²¹ *ASX Listing Rules* Guidance Note 8 Continuous Disclosure September 2001 par 60.

¹²² McGregor-Lowndes M 'Corporate Disclosure, the Internet and the Australian Securities Commission' (1996) 14 *Company and Securities Law Journal* 219-247 at 224. Richard Humphry, Managing Director ASX, made this suggestion at a Securities Institute seminar, Sydney 9 November 2000.

¹²³ Australian Stock Exchange Limited 'ASX and Corporate File Launch Open Briefing' *ASX Announcements* 15 September 1999; An advertisement of its first 'open briefing' and register for notice of briefings was placed by Newcrest Mining Limited in *The Australian Financial Review* (7 December 1999) 25. Other advertisements for open briefings appeared for the ASX half-year results (1 March 2000) 21, and BRL Hardy's full year results (8 March 2000) 25.

Mandatory Disclosure

Discussion in this chapter has concentrated on the changes introduced by compulsory continuous disclosure to complement the mandatory periodic disclosure rules. At this point it is appropriate to ask why the regulators have chosen the path of mandatory, rather than voluntary corporate disclosure? What are some of the theoretical arguments that form the basis of this decision?

As in all discussions of market regulation, the law and economics movement encompasses divergent liberal and conservative views. Many arguments advocate strong mandatory disclosure regulation. Alternatively, the *laissez faire* attitude is that market participants will, by competition, self-regulate the market. This contrasts with liberal doubts concerning the equity of unregulated markets. The liberals claim that, even if markets appear to be acting efficiently, theories of justice should take precedence.¹²⁴

Malloy¹²⁵ adamantly states that his work on law and economics rejects the *laissez faire* approach. He supports an active role for government but recognises that it might be necessary to place a limit on government intrusion into the private sphere. In contrast, Posner¹²⁶ considers himself to be a ‘pragmatic economic libertarian’¹²⁷ who is suspicious of public intervention. His view is that the role of government is to intervene and correct only when there are ‘serious market failures’.¹²⁸

A market decline of 50 per cent over a period of seven weeks could rank as one of Posner’s ‘serious market failures’.¹²⁹ It could validate the intervention of the legislators who enacted mandatory continuous disclosure under s1001A/674. Criticism of the ‘excesses of the 1980s’¹³⁰ placed political pressure on regulators to bolster this perceived unsound foundation to make it suitable for general

¹²⁴ Altman A *Arguing About the Law* Washington Wadsworth Publishing Company 1996 at 171.

¹²⁵ Malloy RP ed *Adam Smith and the Philosophy of Law and Economics* London Kluwer Academic Publishers 1995 at 130.

¹²⁶ Posner RA ‘An Economic Approach to Legal Procedure and Judicial Administration’ (1973) 2 *Journal of Legal Studies* 399-458 reprinted in AW Katz ed *Foundations of the Economic Approach to Law* New York Oxford University Press 1998 at 133.

¹²⁷ Posner RA ‘Law and Economics *is* Moral’ reprinted in RP Malloy, note 125 at 169.

¹²⁸ *Ibid*, at 170.

¹²⁹ The ASX All Ordinaries share price index fell from 2306 on 21 September 1987, an all time high at that point, to 1151 on 11 November 1987. This was a decline of 50 per cent.

¹³⁰ CASAC (1996), note 26 Appendix 6 Executive Summary at 1.

investors. In contrast, Watts suggests that blaming a market crash on a lack of disclosure and then regulating disclosure is a ‘convenient solution for political entrepreneurs’.¹³¹

Posner’s theory of ‘wealth maximisation’ advocates efficient legal rules to bring the allocation of resources under the control of the person who values them the most.¹³² He states that such an approach assists systematic thinking in the area of contract, tort, property law and those areas of criminal law that are not codified but are based on the common law. If common law is an efficient vehicle for the allocation of resources, then it is probably because it is judge made law, which has been refined over the centuries by innumerable judicial decisions. The scarcity of judicial decisions in the black letter law area of continuous disclosure does little to support the common law efficiency argument.

Easterbrook and Fischel¹³³ argue that institutions, securities analysts and lawyers are the main beneficiaries of Securities Exchange Commission (SEC) enforcement of mandatory disclosure. A search for the ‘public interest’ justification behind the 1933 and 1934 securities legislation in the US, concludes:

“We cannot say that the existing securities laws are beneficial, but we also are not confident that their probable replacements would be any better.”¹³⁴

In commenting on the above paper, Coffee¹³⁵ agrees with the important role of securities analysts in disseminating market information. Even in a semi-strong efficient market, where share prices reflect all publicly available information, a case can still be made for a mandatory disclosure system. The primary purpose of such a regime is to provide technical information to analysts and market professionals ‘on the reasonable premise that they are the motorforce that principally keeps the market efficient’.¹³⁶ Beaver,¹³⁷ is the author of a chapter on the efficient market hypothesis in the

¹³¹ Watts RL ‘Corporate Financial Statements, a Product of the Market and Political Processes’ (1977) 2 *Australian Journal of Management* 53-75 in R Ball and CW Smith Jnr eds *The Economics of Accounting Policy Choice* New York McGraw-Hill Inc 1992 at 21.

¹³² Altman, note 124 at 155.

¹³³ Easterbrook FH and DR Fischel ‘Mandatory Disclosure and the Protection of Investors’ (1984) 70 *Virginia Law Review* 669-715 at 671.

¹³⁴ *Ibid*, at 671, 715.

¹³⁵ Coffee JC Jr ‘Market Failure and the Economic Case for a Mandatory Disclosure System’ (1984) 70 *Virginia Law Review* 717-753 at 747.

¹³⁶ *Ibid*.

1977 *Report of the Advisory Committee on Corporate Disclosure to the SEC*. He concurs with the general opinion, that even if one accepts the efficient market hypothesis, 'it does not necessarily follow that there is no social benefit to mandatory disclosure'.

Mandatory disclosure is designed to ensure an informed market. However, if a company withholds information, it can lead to a rational response that causes investors to vacate the market for fear of buying a 'lemon'. Akerlof¹³⁸ observes the economic consequences of imperfect information in the market place. Information asymmetry can exist between producers or sellers who possess knowledge of the product, and buyers who become over cautious because they do not have access to the information. A market that is perceived to have a one-sided bias will lose participants. The cost of non-disclosure can include the loss incurred by the market 'from driving legitimate business out of existence'.¹³⁹

To supplement mandatory periodic reports, analysts will search for additional information gleaned through company visits, discussions with management and industry experts. Although there is always the consideration of time and other costs associated with gaining additional information,¹⁴⁰ no two analysts will interpret the information in the same way, so there will not necessarily be duplication or waste of effort.

Even if disclosure of all material information is mandated, investors and analysts will still need to evaluate the information and translate it into a market bid or offer. The quantity of available information adds to costs incurred by analysts and informed investors in becoming better informed. Unless these costs can be recovered by the discovery of price sensitive information, there are no incentives to engage in additional research.

¹³⁷ Langevoort DC 'Theories, Assumptions and Securities Regulation: Market Efficiency Revisited' (1992) 140 *University of Pennsylvania Law Review* 851-920 at 874.

¹³⁸ Akerlof GA 'The Market for 'Lemons': Quality, Uncertainty and the Market Mechanism' (1970) 84 *The Quarterly Journal of Economics* 488-500 reprinted in *An Economic Theorist's Book of Tales* Cambridge University Press 1984 Chapter 2 at 7-22.

¹³⁹ *Ibid*, at 16.

¹⁴⁰ Blair M 'The Debate over Mandatory Corporate Disclosure Rules' (1992) 15 *University of New South Wales Law Journal* 182-195 at 187.

Market Surveillance

If ASIC and ASX demand mandatory continuous disclosure, then improved surveillance is required to monitor market trading and detect any non-compliance with the listing rule. Following the unification of the six state exchanges and the formation of ASX on 1 April 1987, a new Surveillance section was created in 1989 to monitor stock market activity. ASX Surveillance investigates any unusual share price or volume movements that cannot be adequately explained by information readily available to the stock exchange. If, after investigation, it appears that there has been a breach of the legislation, listing rules or business rules of ASX, then a report is sent to the Companies or Membership departments of the stock exchange or to ASIC.¹⁴¹

The need for stock market surveillance systems was recognised in the US and Canada in the early 1980s and developments in Australia have been closely modelled on these systems.¹⁴² The aim is to be proactive, not simply reactive, and this involves the interaction of systems and databases to maintain surveillance of the market.

The SOMA (Surveillance of Market Activity) system is a real-time, on-line system where exception reports 'alert' ASX to market irregularities. Each alert is referred to an analyst who assesses current market conditions and company announcements to determine whether publicly available information can explain market activity. ASIC's database, news services, broker research and other financial publications are available online and can be integrated with a SOMA investigation. Stock exchange trading on SEATS (Stock Exchange Automated Trading System) can be replayed to enable transactions of brokers, and also their clients, to be reviewed in detail.¹⁴³

One of the surveillance priorities is to ensure a fair and efficient market by the promotion of adequate disclosure. Surveillance will contact the Companies section of ASX if there is a significant unexplained change in a company's share price or volume, or if it detects rumours in the market concerning information that should have been disclosed. If ASX considers specific market

¹⁴¹ Berry J and G Yanco 'Enter the ASX Computer Police: How an Electronic Eye Spots the Villains' (1990) March *Journal of the Securities Institute of Australia* 2.

¹⁴² Aitken M and J Berry 'Market Surveillance at the Australian Exchange: An Overview' 5th Draft July 1991 in University of Sydney Department of Finance *Trading and Dealing in Securities Markets* Finance 304 vol 1 at 3.

¹⁴³ Australian Stock Exchange Limited 'ASX Surveillance Division: Overview of Surveillance Systems' (undated pamphlet) at 1-3.

movements are unexplained by publicly available information, it will query the company as to whether the market is fully informed.

In its 1996 annual report, ASX acknowledged the contribution of Surveillance to the oversight of the market. Four million trades on the equities market in the 1995-96 financial year generated 42,000 alert signals from the SOMA system. A number of alerts can result from a particular pattern of trading in a company's securities and this will lead to an investigation. ASX reports that these:

“...alerts led to 320 queries from ASX to listed companies to ensure the market was fully informed, 51 investigations of possible malpractice and 23 referrals to the Australian Securities Commission”.¹⁴⁴

The number of alerts has more than doubled since the 1995-96 period of the study for this thesis. In 1999-2000, there were 114,000 alerts from which 642 cases of abnormal price movements were investigated by ASX Surveillance, compared with 213 in 1995-96, while only 17 potentially serious breaches of the listing rules were referred to ASIC.¹⁴⁵ In 2000-2001, the number of alerts declined by 25 per cent, reflecting ‘a return to more regular patterns of trading as opposed to those experienced during the technology boom’.¹⁴⁶ There were 24 referrals to ASIC on market matters and 23 referrals on company matters, only four of which concerned listing rule 3.1.¹⁴⁷

SOMA alerts of unusual price or volume movements that are unexplained by an existing company announcement, or by industry or market events, will be queried by ASX. The unusual price movement can result from an insider trade, due to the company's failure to disclose material information. If there is no satisfactory reply to the stock exchange's trading induced query, ASX will instigate an investigation of the alert and if appropriate the matter will be referred to ASIC.

If the regulator concludes that there is a breach of the continuous disclosure provisions then an action can be taken against the company and civil or criminal penalties may apply. The penalties, including civil penalties introduced by the *Financial Services Reform Act*, are discussed in Chapter 5.

¹⁴⁴ Australian Stock Exchange Limited *Annual Report 1996* at 20.

¹⁴⁵ Australian Stock Exchange Limited *Report to Shareholders 2000* at 29.

¹⁴⁶ Australian Stock Exchange Limited *Annual Regulatory Report* September 2001 at 35.

¹⁴⁷ *Ibid*, at 32, 35.

Summary

Chapter 1 provided an introduction to the topic of this thesis. Chapter 2 sets out the legislative and regulatory background of the continuous disclosure provision and ASX listing rule 3.1. It recognises the development of continuous disclosure through the listing rules of the Australian stock exchanges. The chapter discusses the strong contractual basis for the disclosure obligation of listed companies that was first established in the late 19th century listing applications of the stock exchanges in Sydney and Melbourne. This obligation is linked through the listing rules and securities legislation to its present form in the *ASX Listing Rules* and the *Corporations Act*.

In addition, Chapter 2 provided a background to contemporary issues concerning continuous disclosure and its relationship with mandatory periodic disclosure. The legal context of the disclosure regulation is continued in Chapter 5. The empirical study that complements the legal analysis of continuous disclosure is the subject of the following Chapter 3. The chapter will discuss the efficient market theory, the data collection process and price and volume analysis of the 427 queries in the empirical study.

CHAPTER 3

Data Collection and Analysis

Efficient Market Theory

The efficient market theory underpins the empirical study of this thesis. As explained below, the semi-strong form of the theory accommodates the selective release of information revealed by the empirical study. This information has not been publicly disclosed but its existence has become known to the market through a failure of corporate confidentiality, leading to insider trades or the deductions of an astute investor based on the existing public disclosures.

The price that investors are prepared to pay for shares in a company is said to represent the present value of the future benefits or cash flows that an investor expects to gain from the investment. The future cash flows that arise from a share investment will usually include dividend payments and any capital repayment made by the company, as well as a capital gain, or loss, on the sale of the shares. The market value of a share is dynamic and will alter during trading to reflect available information and the often rapidly changing expectations of market participants. Information about a company is made available to the market by voluntary and mandatory disclosure, media coverage, analyst reports, rumour and insider trades. It can be argued that insider trades allow share prices to more quickly incorporate the price effects of non-public information.¹⁴⁸

Three types of market efficiency are defined. These are based on the type of information that is reflected in the prices of securities trading on the stock market. In the weak form of the efficient market hypothesis, the information set used in determining the price of a company's securities is limited to the historical prices for those securities. The current price of the securities is said to be weak form efficient if it fully represents past price information. Successive price changes follow a 'random walk' as they are independent of each other and do not necessarily follow a particular pattern.¹⁴⁹

¹⁴⁸ Whincop, note 30 at 217.

¹⁴⁹ Castagna AD and MT Skully eds *Capital Market Efficiency: The Empirical Evidence* University of NSW 1977 at 3-4.

Technical analysts chart a company's share price movements in anticipation that the patterns formed by these price changes will be repeated. Such analysts operate as if an understanding of these patterns can be used to predict future price movements and provide above average gains to the chartists. In contrast, the random walk theory states that past price movements have no memory and cannot be used to predict future prices, as share prices are quite independent of any prior pattern of price movement.¹⁵⁰ Any informational value from previous prices is already absorbed into the current share price.

The semi-strong form of the efficient market hypothesis extends the information set used by the market. The theory proposes that securities prices are efficient in that they accurately reflect all publicly available information concerning those securities. This public information includes the past price history of the shares. The strong form of the hypothesis goes further than the other two versions to state that the value of a company's securities represents all information relevant to that company, whether the information is publicly available or not.

If the Australian market were strong form efficient, there would be no variation in the price of a company's securities when new material information is released. The value of such information would have already been included in the share price prior to its release. However, in spite of pre-release information that is already absorbed by the market, there are many occasions when variations in the share price of a company are instigated by an announcement made to the stock exchange. This indicates that the strong form of the efficient market hypothesis is invalid. It is the semi-strong notion of efficiency that is relevant to a study of continuous disclosure.

Price sensitive information can reach investors and potential investors via disclosure by the company and reports by analysts and the media. In addition to these outlets, information is available to investors through insider trades. This information does not come to the investor in the form of a detailed release concerning the company. It is simply knowledge that someone, the insider, has a different expectation of the company's future value. This difference is reflected in the price at which an insider is prepared to buy or sell the securities. When an insider trades, rather than just holding the information confidentially, the market can adjust to the additional information made public through the actions of the insider.

¹⁵⁰ Fama EF 'The Behavior of Stock-Market Prices' (1965) 38 *Journal of Business* 34-105 reprinted in Castagna and Skully, note 149 at 3.

Professional analysts and traders in the market ensure that the full effects of new information will be quickly incorporated into the share price. As the information is evaluated, the bids and offers of the traders will realign any over-adjustment or under-adjustment of the price. This realignment can be a reaction to actual disclosure of information or to anticipated future disclosure.¹⁵¹ Early studies suggested that, on average, the effect of new information concerning a particular company was absorbed by the market price of the shares soon after the announcement was made. These studies lent support to the view that the stock market was 'efficient' in the sense that stock prices adjusted rapidly to new information.¹⁵²

A market, which is efficient in the transfer of information, will prevent those traders who have no special information from making abnormal profits. Those investors, securities analysts or insiders, who consider that they possess special price sensitive information, will buy or sell accordingly. As so many investors are competing for this information, the efficient market model predicts that the value of the special information will be limited and short-lived. Other traders will take advantage of the signal given by the unusual price movement and trade on the basis of the information. This will usually bring the market back into equilibrium, a balance between the buyers and sellers.¹⁵³

Market professionals, who closely follow a company's activities, can be aware as soon as an insider accesses the market that potentially price sensitive undisclosed information exists. This knowledge is gained by observing a bid, an ask or an actual trade. A buying bid that is higher than the existing one, an offer to sell that is lower than an existing asking price, or a trade executed at a higher price or turnover can all act as signals. Although it is inadequate in conveying the context of any information, an insider trade can effectively disclose the presence of price sensitive information. A market trade adds to the collective information on the company that is publicly available, thus exhibiting the semi-strong form of the efficient market theory.

However, in fulfilling its regulatory responsibility to maintain an informed market, ASX requires a more detailed explanation of any undisclosed price sensitive information that might have prompted an insider trade. As discussed in Chapter 2 under *Market Surveillance*, the stock exchange's SOMA

¹⁵¹ Ibid, at 18.

¹⁵² Fama EF, L Fisher, MC Jensen and R Roll 'The Adjustment of Stock Prices to New Information' (1969) 10 *International Economic Review* 1-21 reprinted in Castagna and Skully, note 149 at 86.

¹⁵³ Scholes MS 'The Market for Securities: Substitution versus Price Pressure and the Effects of Information on Share Prices' (1972) 45 *The Journal of Business* 179-211 reprinted in Castagna and Skully, note 149 at 111.

system monitors these unexplained trading patterns. SOMA will consider the available company, industry and market information to explain any unusual trading pattern. If there is no obvious explanation, ASX will request timely disclosure by the company to ensure that, in fairness to all investors, the market receives any material information. It is data concerning the ASX request for additional disclosure, and the company's reply to this request or query, that are collected and analysed in the following sections of this chapter.

Data Collection

The stock exchange issues a query notice to a listed company when it is uncertain whether the market is fully informed. A request for additional information will often result from unexplained movements in a company's share price. Alternatively, the query will result from a need for clarification of a company's existing periodic disclosure. Once a satisfactory reply is received from the company, both it and the ASX query are disclosed to the market. As discussed in Chapter 1, in the section on *Significance of the Research*, these announcements to the market are stored electronically and then transmitted as Signal G to selected users.

Although the list of companies queried by ASX was obtained from Signal G, data for the analysis of ASX queries in this thesis were obtained from the original company announcements released to the stock exchange. The Stock Exchange Collection at the Department of Accounting, University of Sydney, held the primary source material of all public announcements released by listed companies to ASX from January 1980 to September 1996. However, only the primary source material from the company files for 1995 and 1996 was accessed for this thesis.

The Brown *et al* study in CASAC (1996) *Report on Continuous Disclosure* includes, in Table 1 of Appendix 8,¹⁵⁴ the numbers of publicly released company announcements classified according to ASX sub report codes. This division into the type of reports submitted to ASX is tabulated for all 1,474 listed entities for the pre-ED period and for the post-ED period.¹⁵⁵ The ASX sub report code categorises the announcement made to ASX. For example, 01 is a takeover announcement, 03 is a periodic report such as a half-yearly or a preliminary final and sub report code 17 represents an ASX query to a listed company.

¹⁵⁴ CASAC (1996), note 26 Appendix 8 at 21.

¹⁵⁵ *Ibid*, Appendix 8 at 5: The pre-ED period in Panel A of Table 1 was defined as 29 August 1992 to 4 September 1994 (approximately 24 months), while the post-ED period was from the 5 September 1994 to the 31 March 1996 (approximately 19 months).

It is not possible for this study to adopt the same pre-ED and post-ED comparative model used in the CASAC study, as queries made by the stock exchange to listed companies were grouped with other announcements in the pre-ED period. Queries requesting further company information were not assigned a separate ASX sub report code until July 1995.¹⁵⁶ The earliest Signal G record of a response to an ASX query occurred in the post-ED period, on 3 July 1995.

Table 1 in the Brown *et al* study records 415 query notices issued by ASX within the post-ED period. There were no query notices within the pre-ED period, as a specific sub report code had not been allocated to ASX queries at that time. On request, Professor Philip Brown supplied a list of ASX codes and dates of queries issued by the stock exchange to listed companies in the post-ED period. This list was compiled from ASX data that provided the sub report code categories for the documents in the CASAC study.

The Brown list records 427 queries made by ASX to 272 separate companies during the post-ED period. The listed query dates occurred between the beginning of July 1995 and 4 April 1996, making the sample period for this study approximately 9 months. Price and volume data utilised for the study in this thesis span the 12 month period from May 1995 to the end of April 1996.

ASX original company files, located at the University of Sydney, were checked to confirm the correspondence concerning each of the 427 queries. The date of an ASX query and the reply date were noted, together with the branch of ASX responsible for the query and the reason for the query. This information was obtained from query letters sent by ASX to individual companies. The reason for non-disclosure was deduced from correspondence sent by the company to ASX in reply to a query. Additional explanatory information was often found in company announcements and correspondence in a period of up to two months prior to and after the reply date. In 11 instances, either the query date or the reply date was not available as the relevant correspondence between ASX and the company was missing from the company file. In these instances it was not possible to confirm the dates given in ASX's Signal G.

¹⁵⁶ Brown *et al* (1996), note 25 Appendix 8 at 21 Table 1, ASX Sub Report Code 17, ASX Query.

Abador Gold NL Query 1

The following is an example of an ASX query. Abador Gold NL¹⁵⁷ notified ASX on 30 August 1995 that the company had signed a heads of agreement document, which would enable them to obtain 80 per cent of the ‘British Hill’ mining tenements. Eclipse Ridge Pty Ltd controlled these tenements in Western Australia.

The following day, the Companies section of ASX in Perth queried Abador concerning its association with Eclipse Ridge Pty Ltd as contemplated by listing rule 3J(3)(a) (new rule 10.1, 10.2) and 3J(37) (new rule 1.1 condition 10, 10.7). ASX requested a response in a format suitable for release to the market by 5.00pm, Friday 1 September 1995. Abador complied with ASX’s request on that date by stating that the company had no association with Eclipse Ridge Pty Ltd as contemplated by the listing rules mentioned above.¹⁵⁸

The basis of the ASX query was that a listed entity, such as Abador Gold NL, must ensure that neither it nor any of its child entities acquired a ‘substantial asset’ from, or disposes of a ‘substantial asset’ to, a related company without shareholder approval (listing rule 10.1). An asset is defined as ‘substantial’ if its value, or that of the consideration, is five per cent or more of the equity interests of the entity (listing rule 10.2).

Abador was asked to clarify whether the agreement to obtain the British Hill mining tenements could be considered an acquisition from a related party or a subsidiary of a ‘classified asset’. If the acquisition had fallen within the contemplation of listing rule 10.1 then the tenements would have been considered a classified asset. In which case, the consideration paid by Abador must be in the form of restricted securities, unless the consideration is a reimbursement of expenditure incurred in

¹⁵⁷ Abador Gold NL was classified by ASX as a mineral explorer. The company’s market capitalisation at 31 December 1995 was \$5.47 million. Abador Gold planned major nickel exploration at its Mulgarrie tenements following the high grade discovery at Silver Swan in late 1995. The site of Mining Project Investors Pty Ltd at Silver Swan is just south of the Abador tenement in Western Australia. Abador Gold is involved in a number of exploratory gold projects in Western Australia and South Australia. Sources: Australian Stock Exchange Limited *Industry Classification Report* July 1992; ASX Industry Classification and Market Capitalisation list at 31 December 1995; Abador Gold NL Annual Report 31 December 1995 and 1996.

¹⁵⁸ Australian Stock Exchange and Abador Gold NL correspondence between 30 August and 1 September 1995. Stock Exchange Collection, University of Sydney.

developing the classified asset (listing rule 10.7). Restricted securities have an escrow period during which they cannot be traded (listing rules Appendix 9B).

Abador stated in its announcement of 30 August 1995, that the consideration for the British Hill Group of tenements was a work commitment over a period of 24 months. This was valued at \$1 million, in addition to the issue to Eclipse of 2 million Abador shares and 1.5 million options to subscribe for Abador shares. Abador also agreed to provide a loan of \$200,000 to Eclipse. As there was no follow-up inquiry on this reply to its query, ASX was satisfied that the stock exchange and the market were now fully informed. ASX accepted that as the two companies had no association within the terms of the above listing rules then any shares issued by Abador, as consideration, need not be restricted securities.

Trading Induced and Technical Queries

The above ASX query notice to Abador is considered an example of a technical query. The initiation of this query by the stock exchange does not flow directly from unexplained variations in the share price or market turnover of the listed company. In its reply to ASX on 30 August 1995, Abador attempted to comply with its disclosure obligations under s1001A/674. The stock exchange's query notice sought additional technical information on the company's position under the listing rules, rather than querying any volatility of its share price.

Where a variation of a company's share price forms the primary impetus for the stock exchange query then the initial and final price, occurring on the specific dates nominated by ASX in the query notice, are recorded. In these trading induced queries, ASX is concerned with the variation between these two specific share prices. The initial price and the final price for a stock are designated as **P1** and **P2**¹⁵⁹ in the data. The dates on which these prices occurred are given in the ASX query notice and are designated as **D1** and **D2** in the data. Of the 427 queries in the sample 187, or 43.8 per cent, result from unexplained variations in the company's share price over the period of time specified in

¹⁵⁹ **P1** for each trading induced query is the price of the company's shares at **D1** as shown in the query notice from ASX. Prices are given in cents per share and have been rounded to the nearest half cent. **P2** is the price of the company's shares at **D2** as shown in the query notice from ASX. **D1** is the initial date of the company's share price as chosen by ASX and shown in the query notice to the company. **D2** is the final date of the company's share price variation as chosen by ASX and shown in the query notice which is sent to the company. **D2** is usually the same day as the query date, or the day before the query date. The query date is the date on which ASX faxed or sent the query notice to the company.

the query notice, the period between **D1** and **D2**. These queries are designated as ‘trading induced’,¹⁶⁰ while the remaining queries are considered ‘technical’.

The technical inquiries made by ASX, 240 or 56.2 per cent of the sample, usually involve some omission or ambiguity concerning the company’s periodic disclosure under the listing rules. In certain cases the company’s reply to a technical query can be directly or indirectly price sensitive.

Abador Gold NL Query 2

As previously discussed, ASX’s query of Abador Gold NL on 31 August 1995 was considered an example of a technical query for the purposes of this study. However, within the time period of the study, ASX also queried Abador regarding perceived non-disclosure by the company on two further occasions. Both of these query notices were the result of unexplained variations in the company’s share price, so the queries were designated as trading induced.

On 21 November 1995, ASX Perth queried recent fluctuations in the price of Abador’s securities from 14 cents to 20 cents between 17 and 21 November. The query notice follows the format established in most of the trading induced queries. It is a format that is consistent with s1001A/674. ASX reminds the company that the principal objective of listing rule 3.1 is to secure immediate release of information that might reasonably be expected to have a material effect on market activity and prices of quoted securities. ASX states that it wishes to make:

“the following inquiries:

1. Are any matters of importance concerning the company about to be announced to shareholders and the market? If so, can an announcement be made immediately?
2. Is the company aware of information concerning the company which, if that information were generally available to the public, might reasonably be regarded as an explanation for the recent trading in the securities of the company? If not is the company able to offer any explanation for the information of shareholders and the market?
3. Is the company able to confirm that the market in the securities of the company is fully informed and that the company is complying with the listing rules of ASX?

¹⁶⁰ In the data, the degree of price sensitivity is dependent on whether the stock exchange considers the situation that prompted the query to be immediately trading induced or not. If ASX queries the company because of recent fluctuations in the price of its securities then the query is designated ‘y’ for yes, the situation is trading induced. If ASX queries the company for a reason other than a fluctuation of the share price then the data for that query is designated ‘n’ for no as the information required is not anticipated to be immediately price sensitive.

4. Does the company have any reason to believe that there will be a change in the operating profit/loss before abnormal items and tax such that the figure for the current year would vary from the previous corresponding year by more than 15%?
5. Does the company have any reason to believe that it will record any material abnormal or extraordinary profits or losses for the current year?"¹⁶¹

This correspondence also highlights a dilemma of continuous disclosure regulation, namely, that ASX does not always know which questions it should be asking the company. The stock exchange considers that its questions 'cover matters of current specific interest to ASX'. In spite of the seeming generality of the above five queries, ASX admits that it 'cannot be aware of all the information which would be required to ensure that the market is properly informed in accordance with Section 3A [rule 3.1] of the Listing Rules'.¹⁶² The query notice to Abador then emphasises that the company's responsibility is not confined to, or necessarily discharged by, answering the specific requests set out in the correspondence. A reply to the query notice is requested from Abador by the commencement of trading the following day, Wednesday 22 November 1995.

In this instance the company replies promptly, on the same day as ASX's query. Abador Gold NL faxes an explanation for the recent price fluctuations of the company's securities at 1.38pm, 21 November. An announcement concerning the company's interest in the Mulgarrie project is attached for immediate release to the market. This project is only a few kilometres from a recent nickel discovery announced that day by Mining Project Investors Pty Ltd.¹⁶³ Abador states that this recent discovery is the principal reason for the fluctuation in the company's share price. The reply also includes the standard confirmation that the market is fully informed and that the company is complying with the listing rules of ASX.¹⁶⁴

Abador Gold NL Query 3

A little over two months after Query 2, ASX Perth again queried fluctuations in the price of Abador's securities. On 7 February 1996 the stock exchange requested an explanation for movements in the company's share price from 16 cents on 2 February 1996 to 27 cents on 7 February 1996. The format

¹⁶¹ Australian Stock Exchange and Abador Gold NL correspondence of 21 November 1995.

¹⁶² Ibid.

¹⁶³ This discovery is discussed in a later section of this chapter on *Mount Kersey Mining NL*.

¹⁶⁴ Australian Stock Exchange and Abador Gold NL correspondence of 21 November 1995.

of this query notice is identical to that sent to the company on 21 November 1995. Abador again responds promptly, on the same day as the query, by faxing a reply to ASX at 5.15pm.

On this occasion, Abador states that no matters of importance concerning the company are about to be announced to shareholders or to the market. The company suggests that recent press and market preoccupation with parties that hold interests in close proximity to the Silver Swan nickel discovery is the principal reason for fluctuations in the company's share price. Abador admits that since lodging its quarterly report on 9 January 1996, it has obtained recently processed data concerning one relevant exploration site that is still being assessed. The correspondence concludes with the standard confirmation that the market in the company's securities is fully informed and the company is complying with the listing rules of ASX.¹⁶⁵

These three episodes concerning Abador Gold NL illustrate the query procedure of ASX, further, it is the first company, ranked by ASX code, to receive more than one query notice during the sample period. It is an appropriate example as the ASX correspondence relates to both 'trading induced' and 'technical' queries according to the definitions used in this study. Queries 2 and 3 are topical because the company's mining interests are 'in close proximity' to the Silver Swan nickel discovery. Market trading in securities of Mt Kersey Mining NL, resulting from this discovery at Silver Swan, was the subject of an unsuccessful insider trading prosecution in 1999.¹⁶⁶

Trading Halt

Additional reading of the company's correspondence with the stock exchange reveals that Abador is also a good example of the use of a trading halt. The standard format of correspondence, sent by ASX Perth to Abador regarding trading induced Query 2 and Query 3, concludes with the remark that the directors could request a trading halt in the company's securities if they are unable to reply within the time requested.

The company is reminded that a trading halt is only available for a period not exceeding the commencement of normal trading on the second trading day after the day the trading halt is requested.¹⁶⁷ If the company were still unable to reply to the query after completion of the trading

¹⁶⁵ Ibid, correspondence of 7 February 1996.

¹⁶⁶ See section on *Insider Trading Case Law* in Chapter 5.

¹⁶⁷ ASX listing rule 17.1.1 and ASX business rule 2.16.2.

halt, then a suspension of trading from quotation would normally be imposed by ASX, assuming that the company has not already requested this suspension. Chapter 19 of the ASX listing rules provides guidance on interpretation and definitions of the terms used. In Chapter 19, ASX is at pains to point out that a trading halt, for the purposes of Chapter 17 on trading halts, suspensions and removals, is an interruption of trading at the request of an entity. It is not a suspension from quotation initiated by ASX.

Rule 17.1.2 states that ASX may suspend quotation of an entity's securities even if the securities are subject to a trading halt. However, if intervention by ASX has not been necessary and the company itself requests a trading halt to prevent uninformed market activity, then ASX will not suspend quotation of the securities before the close of normal trading on that day. A trading halt and a suspension are quite different. The former is designed for the company to initiate. A trading halt receives different treatment on SEATS to a suspension.¹⁶⁸

ASX business rule 2.16.2, formerly rule 2.6(9), outlines the treatment of a trading halt on SEATS. This rule provides traders with the flexibility to alter bids or offers in anticipation of the release of company information during the trading halt. Under the rule, securities subject to the trading halt are placed in the 'pre-opening phase'. This refers to a period of time, not exceeding the trading day on which the trading halt is requested, during which SEATS operators can enter or cancel bids or offers but may not effect transactions through the market.¹⁶⁹

Listing rule 17.1 on trading halts accommodates the non-disclosure of price sensitive information in a situation where disclosure would be required under listing rule 3.1. A company can request a trading halt if information likely to affect the price or value of the company's securities cannot be released immediately. If an immediate reply is not possible, in spite of speculation concerning the company, then the stock exchange, in its discretion, may grant a halt to trading. Also, if ASX queries the trading pattern of the company's securities and is awaiting a reply to this query, then the company is invited to apply for a trading halt. ASX may require the company to make a written request stating the reasons and likely duration of the trading halt. The company should also name the anticipated event that will end the trading halt.

¹⁶⁸ *ASX Listing Rules* Guidance Note 16 Trading Halts September 2001 par 12.

¹⁶⁹ *Ibid*, par 5.

Generally, the request and the reasons for the trading halt are released to the market. However, if the reasons are particularly price sensitive, then these can be included in separate correspondence to ASX and marked 'not for public release' under the conditions of listing rule 15.6. ASX will then only release this confidential information to the public after warning the company in advance.

In the case of Abador, the company replied promptly to both trading induced query notices concerning fluctuations in its share price, so it was unnecessary for it to request a trading halt. However, in the intervening period between Query 2 and Query 3, and without ASX intervention, Abador requested a trading halt at 5.10pm, 30 November 1995. The company submitted this request pending an announcement to be made concerning the company's prospectus dated 16 October 1995. Abador stated that a further announcement would be made within 24 hours.¹⁷⁰

In reply to the request, ASX announced on 1 December that Abador's securities would be placed in the pre-open position until the commencement of trading on Monday 4 December 1995. The company complied with the guidelines for a trading halt by 12.26pm, Friday 1 December. Abador Gold informed the market that the new issue outlined in the company's prospectus of 16 October 1995 had closed under subscribed. As the issue was not underwritten, the company decided to refund to subscribers all application money for the new securities and wait for a more propitious occasion for capital raising. A new underwritten renounceable rights issue was subsequently announced on 21 December 1995.¹⁷¹

ASX Share Indices

To evaluate the significance of the share price movements of a listed company it is necessary to eliminate those price variations that are likely to result from general industry or market conditions. To do this, movements in the company's share price at the time of a stock exchange query can be 'compared' to the movement in market value of a group of similar companies. For example, the movement of Abador Gold's share price over a given time period can be evaluated against the movement of a group of gold stocks that are listed on ASX. Group 1 of the ASX index represents these gold stocks. This index, at any given minute of the trading day, reflects the market capitalisation of the gold mining companies that are included in Group 1, the Gold index.

¹⁷⁰ Australian Stock Exchange and Abador Gold NL correspondence of 30 November and 1 December 1995.

¹⁷¹ Abador Gold NL announcement to ASX on 21 December 1995.

The market capitalisation of a stock represents the total market value of the company, as if all the listed securities in that company were traded at the last sale price of the securities at any particular trading moment. The sum of the market capitalisation of each of the individual companies in Group 1, the aggregate market value (AMV), is then weighted by the market capitalisation of the same group of companies prior to the opening of the first day of trading in 1980.¹⁷² The market capitalisation of a company will fluctuate during the trading day according to its share price movements. There can also be technical alterations, made by ASX overnight, to adjust the value or the number of a company's securities on issue. These adjustments are reflected in the market capitalisation of the company at the opening of trading the following morning.

Such technical alterations will occur whenever new capital is added to the existing issued capital of a listed company. Additions will follow an increase in the paid-up value of contributing, or partly-paid shares, the exercise of company options with the payment of an exercise price on the issue of new securities or the addition of application money on completion of a new issue of shares. There will be no alteration to the market capitalisation of a company if new shares are issued simply as a result of a reorganisation of the company's capital by means of a genuine bonus issue or share split. As no new capital is added to the company, the only change will occur if there is a signalling effect on the value of the securities. It should be noted that a company's market capitalisation might include secondary issues and unlisted capital, both of which are not eligible for inclusion when calculating ASX indices.¹⁷³

The daily movements of ASX share price indices exhibit the changes in this AMV for each index portfolio. A previous day's closing AMV can be technically adjusted where necessary to produce the start of day AMV. As it is a chain index, the previous day's closing index figure and the current day's start of day AMV can be used instead of the 1980 base index and base market capitalisation to calculate the current index.¹⁷⁴

¹⁷² ASX share price indices have been calculated from a base of 500 on 31 December 1979 (source: Australian Stock Exchange Limited *Monthly Index Analysis* 30 June 1996 at 30).

¹⁷³ *Monthly Index Analysis*, note 172 at 2, 8.

¹⁷⁴
$$\text{Yesterday's Closing Price Index} \times \frac{\text{Today's Closing AMV}}{\text{Today's Start-of-day AMV}} = \text{Today's Closing Price Index}$$

(source: Australian Stock Exchange Limited *Fact Book 1995 Statistics* to 31 December 1994 at 23).

In this study, a company's share price is compared to its particular industry group within the ASX indices and the market index, the All Ordinaries.¹⁷⁵ The share price indices only reflect the increase or decrease in the market value of a group of companies. These indices do not indicate the value of dividends that a company has paid out to shareholders instead of retaining the money within the company's capital base. To account for this, the company's dividend amount at its *ex* dividend date is reinvested to calculate the ASX accumulation indices. The *ex* dividend date is the date on which the company first trades without the dividend amount included in its share price. The market will adjust to the payment of a dividend. Bids or offers posted after the opening of trading on the *ex* dividend date will reflect the reduced value of the share.

To compile the accumulation indices, in contrast to the share price indices, this dividend amount is retained in the market capitalisation of the company. This retained capital allows the accumulation indices to rise further, or fall less, than the comparable share price indices.¹⁷⁶ For Groups 1-23, the base of the accumulation indices is taken to be 1000 at 31 December 1979. This distinguishes the accumulation indices from the associated share price indices, each of which has a base of 500.¹⁷⁷

In line with the studies discussed earlier by Brown *et al*, this study calculates abnormal share price returns by comparison with the accumulation indices. Harris and Ramsay¹⁷⁸ also utilised the

¹⁷⁵ Group 24, the Tourism and Leisure index was added in August 1994, with a base of 1000 at 31 December 1990 for both the share price and accumulation indices. Group 24 includes those stocks that obtain the majority of their profits from the tourism and leisure industries (source: *Fact Book 1995*, note 174 at 24). Daily ASX share price and accumulation indices for Group 24 for February 1996 first appeared in the *ASX Journal* April 1996 at 53, note 182. Of the companies included in this study only two stocks, Sydney Harbour Casino Holdings Limited and The Australian Brewing and Hospitality Group Limited, would have been eligible for transfer from Group 21 (Miscellaneous Services) to Group 24. For this reason only Groups 1-23 have been included in statistical analysis for this study.

¹⁷⁶
$$\text{Yesterday's Closing Accumulation Index} \times \frac{\text{Today's Closing AMV} + \text{Today's Dividends}}{\text{Today's Start-of-day AMV}}$$

= *Today's Closing Accumulation Index*

(source: *Fact Book 1995*, note 174 at 23).

¹⁷⁷ *Monthly Index Analysis*, note 172 at 30.

¹⁷⁸ Harris T and I Ramsay 'Measuring the Effects of Legal Change Using Share Price Data: an Analysis of the Impact of the *Mabo* Decision' (1996) 10 *Corporate and Business Law Journal* 113-137 at 113.

accumulation indices in a study to analyse the effect of the *Mabo*¹⁷⁹ decision on the share prices of six listed mining companies.

The overall movement of the Australian market, for the 12 month period that encompasses this study, can be gauged by the change in the All Ordinaries share price indices from the close of trading in June 1995 to the closing index for June 1996. The index rose by 11.2 per cent. This was considerably more than the 3.3 per cent increase of the New Zealand market, comparable to 11.4 per cent rise for the Toronto Stock Exchange (TSE 300) and 12 per cent for the London market (FTSE 100). However, it was less than that of US stock markets, as illustrated by changes in the lead indicators. The Dow Jones Industrials rose by 24.2 per cent while the NYSE composite index and the Standard and Poors' 500 both added 23.1 per cent.¹⁸⁰

Sample

Unless otherwise stated, all tables and figures referred to can be found in Appendix 3. The total sample size is 427 queries but, as noted previously, for the purpose of analysis it is divided into trading induced and technical queries. These two groups are further subdivided into ASX queries to mining companies and queries to industrial companies. There are 187 trading induced queries consisting of 101 mining queries and 86 industrial queries. The 240 technical queries are comprised of 155 mining queries and 85 industrial queries. All entities in the sample are listed 'limited liability' or 'no liability' companies with the exception of one trust.¹⁸¹

This division of the queries into mining and industrial has a valid and practical basis. Listed securities are identified on the electronic SEATS trading system by a simple three letter alphabetical code for the prime securities. There is no longer the separation of the mining market from the industrial market as there was on the trading boards of the 1980s and earlier. However, the division still remains in the price and volume data presented in the daily press and the *ASX Journal*.¹⁸² The

¹⁷⁹ *Mabo v Queensland (No 2)* (1992) 175 CLR 1.

¹⁸⁰ *Monthly Index Analysis*, note 172 at 10, 11.

¹⁸¹ Sydney Oil Company Drilling and Exploration Trust.

¹⁸² Australian Stock Exchange Limited *ASX Journal* (insert in *Shares 1996-*); *SXJ: The Australian Stock Exchange Journal 1990-1996*.

market is still segmented into mining or industrial according to which index group, and the companion industry classification, is most appropriate.¹⁸³

This segmentation of the market can produce certain anomalies. For example, the former Broken Hill Proprietary Company Limited was a leading industrial stock and was classified as such in published price and volume lists, but it was included with the mining companies in Group 5 for Diversified Resources in index and industry classification tables.¹⁸⁴

An indication of the industry classification of all the sample companies was noted.¹⁸⁵ The relevant prime industry classification code was obtained from an ASX publication, which itemised the main industry group of all companies listed at July 1992. This information was updated where necessary by reference to the 1996 edition of *Who Audits Australia?*¹⁸⁶

Price data were sometimes unavailable for between one and three of the main time periods of this study (prior, mid and post). Most of the missing price information concerned the technical industrial queries. In a total of 29 queries, share prices were unavailable in the prior to mid period and in 28 instances data were missing in the two later periods.¹⁸⁷ Data were usually unavailable because there was no trading in the securities, and therefore no current price, or because trading was suspended by ASX for an extended period. In one case, Qantas, the queries were issued by ASX prior to the company's listing on the stock exchange. As the stock had not yet traded, these queries to Qantas were not trading induced and were concerned with the company's share registry commitments.

¹⁸³ Table 11.

¹⁸⁴ Although it is used to illustrate potential anomalies of market segmentation, Broken Hill Proprietary Company Limited is not a sample company for this study. There is no record on Signal G of an ASX query to the company during the 1995-96 time period of the study. However, the company was the subject of dispute with ASX concerning the continuous disclosure listing rule 3.1 in late 1996 (Frith B 'Equivocal ASC Damages Share Market Integrity' *The Australian* (23 April 1997) 31 and 'Oil on Troubled Waters is Hardly Good for Investors' (4 November 1997) 22).

¹⁸⁵ Table 11.

¹⁸⁶ *Industry Classification Report* July 1992, note 157; AT Craswell *Who Audits Australia?* University of Sydney Accounting Foundation December 1996 Table 15 'Companies Listed by Industry and Auditor' at 105-138.

¹⁸⁷ Column 2 of Table 14 records the number of queries for which price information was unavailable in each of the categories for the three time periods.

Those companies queried by ASX for non-disclosure were generally small to medium in size. Only ten¹⁸⁸ of the queried companies were sufficiently large to be included in the top 100 companies by market capitalisation. One company, Coles Myer Limited (ranked 13), was eligible for inclusion in a table of the *25 Largest Domestic Companies by Market Capitalisation* at 31 December 1995.¹⁸⁹

The state branch of ASX that initiated each query was also recorded.¹⁹⁰ Many of the 256 mining queries emanated from ASX Perth as it had home branch responsibility, previously home exchange responsibility, for the many mining companies with West Australian operations. 'Home Branch'¹⁹¹ is defined as the State Office of the Exchange designated to a company by the Australian Stock Exchange Limited as its Home Branch for administrative purposes.

Descriptive Statistics

Tables 1.1, 2.1 and 2.2 record the descriptive statistics of a particular sector, for example the companies in the trading induced mining group of queries, or for the total sample. The percentage change in the company's share price is adjusted by subtracting the percentage movement in the relevant index in order to isolate any abnormal variation of the share price.

The average or arithmetic mean of the percentage variations of the companies' abnormal return is the first of the descriptive statistics shown in the above tables. The mean provides an indication of the percentage movement of the sector as a whole. This statistical measure has some disadvantages. If falling price movements cancel the rising price movements, and if the totals for these categories are equal in frequency and size, then the resulting mean will be zero. Also, if there is an extreme price variation at either end of the sample range, this can distort the result unduly in that direction. As there are a number of extreme price movements in this study, the median, or the value in the middle of the data set, is often a more appropriate indicator of the overall variation of the sector.

¹⁸⁸ The ten companies were Coles Myer Ltd, Homestake Mining Company*, Qantas Airways Limited, Advance Bank Australia Limited, St George Bank Limited, Gold Mines of Kalgoorlie Limited, Battle Mountain Gold Company,* James Hardie Industries Limited, Ampolex Limited and Bank of Melbourne Limited. Source: Australian Stock Exchange Limited, Index Services, special computer run of industry classification and market capitalisation of listed companies at 31 December 1995. (* market capitalisation for these two companies is in \$US.)

¹⁸⁹ Australian Stock Exchange Limited *Fact Book 1996* Statistics to 31 December 1995 at 13.

¹⁹⁰ Table 10.

¹⁹¹ *ASX Listing Rules* Definitions 1 October 1995 at 0.8.

The standard deviation (*Stdevp*) of the population of the sample, and its various sectors, measures the variability or dispersion of the results about the mean. The standard deviation can indicate the volatility of the individual price movements in the sample compared with the average price movement. The range of price movements is delineated by the two extreme values in the sample, the minimum and the maximum. In this sample, the minimum is the largest negative price movement in the sector, and the maximum is the largest positive price movement. The range is of limited value as it excludes the frequency and size of all but the extreme values in the sample.

There are similar descriptive statistics in Tables 4, 6 and 8 for the volume variations of the 427 sample companies in this study.

Regression Analysis

In Tables 1.2, 3.1, 3.2 and 3.3 the variables are the abnormal returns on the company's share price and the market, after adjusting the returns for the risk free rate. In Table 5 the variables are the changes in company's trading volume and ASX market trading volume. In Table 7 the variables are the ratios, for two different periods, of the company's trading volume for the month and its average monthly volume for the year. The Table 9 variables are the volume liquidity ratios for two of the periods. The liquidity ratio is the company's trading volume for the month against the number of shares that the company has on issue at the end of the month.

The Capital Asset Pricing Model (CAPM) states:

$$R_i = R_f + \beta(R_m - R_f)$$

where R_i is the return of the firm, R_f is the risk free rate and R_m is the return on the market portfolio.

The results, as shown in Tables 1.2, 3.1, 3.2 and 3.3, are calculated using regression analysis of the following form:

$$R_i - R_f = \alpha + \beta(R_m - R_f) + \varepsilon$$

where α is the intercept, β indicates the sensitivity to the excess market return and ε is the error factor. The risk free rate, R_f , is the average of the Commonwealth 90 day Treasury Note yield for the period **D1** to **D2**. This average annual yield is then converted to the average daily yield between the two respective dates.

The regression shown above is used to measure the way in which one variable is related to the other. In the tables that summarise the results of these regressions, the intercept and slope coefficients, the associated t -statistics, and the adjusted r -square are reported. All the regressions have been calculated using SAS Version Eight and adjusted using White's t -statistics. The intercept is a

measure of the abnormal return earned by the set of firms. Where the return is expected to be positive for companies queried for price increases or negative for those queried for price decreases, a one-tailed test is applied. However, a two-tailed test is used for those companies in receipt of a technical query, as the direction of the excess return is not anticipated.

The *t*-statistic is a measurement of the statistical significance of the results, while the adjusted *r*-square statistic describes the closeness of the relationship between the two variables. The lower the adjusted *r*-square statistic, particularly in the period before the company's reply to ASX, the stronger is support for the hypothesis that companies subject to trading induced queries move independently of the market, possibly on the basis of undisclosed information.

The two data sets analysed, in Tables 1 to 3, represent the percentage variation over a specific period in the adjusted share price of the queried company and the movement in the All Ordinaries accumulation index, also adjusted by the risk free rate, for the same period. In Table 1, the appropriate adjusted industry group accumulation index is also used.

Analysis of Trading Induced Queries (see Tables 1.1, 1.2)

Prior to issuing a query notice to a company concerning any unusual fluctuations in its share price, ASX would check variations in the relevant market indices. This exercise ensures that easily explainable industry or market conditions, such as a change in the gold price or interest rate, do not drive these fluctuations. As a confirmation that ASX queries are targeting the correct companies, the percentage change for the query period between a company's initial adjusted share price, **P1** at **D1**, and final price, **P2** at **D2**, is calculated. This is only possible for those 187 companies where the ASX query was trading induced, as there is no **P1** or **P2** included in the technical query notices.

The percentage changes for the industry group indices and the All Ordinaries accumulation indices are also calculated for the **D1** to **D2** period for each trading induced query. Descriptive statistics for these variations are compiled (Table 1.1), and the adjusted share price returns of the companies are regressed against the adjusted changes in the relevant index groups (Table 1.2).

Descriptive Statistics for Trading Induced Queries

Figure 1 illustrates the unadjusted share price returns of the trading induced queries and the movements of the All Ordinaries accumulation index. The share price fluctuations of the queried stocks are noticeably dissimilar to the movements of the All Ordinaries accumulation index for the

same period. Figure 2 contrasts the abnormal share price returns for those stocks in receipt of trading induced queries with those that have received technical queries in the mid to prior period. Confirmation that ASX is targeting companies with abnormal unexplained share price returns, prior to the query notice, is revealed by the following results.

Mean and median share price movements in Table 1.1, adjusted by both accumulation indices, are positive. This confirms the expectation that the overall share price fluctuations, of all stocks queried for unexplained price movements, are much greater than the industry and market movements. The average price change, adjusted by the All Ordinaries accumulation index, for the sample of trading induced queries is 34 per cent (median 33.35 per cent). The average variation for the mining stocks is 40.98 per cent (median 38.61 per cent), while the industrial group records a lower change of 25.79 per cent (median 25.41 per cent).

Table 14 suggests that in the period prior to a trading induced query being issued by ASX, 63.6 per cent of the subject companies recorded an abnormal price rise, adjusted by the All Ordinaries accumulation index, and 36 per cent registered a fall in share price. The range of adjusted price movements, between the initial date of ASX monitoring and the final date is included in Table 1.1. Dramatic price rises of two to three hundred per cent occurred in both the mining and industrial sectors and are discussed in more detail in the following paragraphs.

The largest fall in a share price during the monitoring period for the trading induced queries, adjusted by the All Ordinaries accumulation index, was 59.94 per cent recorded by Vanguard Petroleum Limited. In its reply to the ASX query, Vanguard attributed this decline to a perception in the Australian stock market of the risks associated with financing and developing the company's investments, which were 'predominantly in Russia'.¹⁹² This is an example where the price fluctuation appears to arise genuinely from deductions based on existing information, rather than a failure to maintain the confidentiality of undisclosed information.

¹⁹² Vanguard Petroleum Limited and ASX correspondence of 5 October 1995. The unadjusted share price declined from 65 cents on 14 September 1995 to 25 cents on 5 October 1995. Vanguard Petroleum Limited is classified by ASX as an oil and gas investor and its market capitalisation at 31 December 1995 was \$18.44 million. At that time, Vanguard's main investment was a 50.3 per cent interest in a high risk Russian venture, Magma Oil Company, in which Russian shareholders held the remaining interests. Magma is involved in oil production and exploration in the West Siberian Basin. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list at 31 December 1995; Vanguard Petroleum Limited Annual Report 31 December 1995.

Goldsearch NL

The maximum price rise in the mining sector in Table 1.1, adjusted for the All Ordinaries accumulation index, was 225.22 per cent. This was the result of an unadjusted price variation of 227 per cent, a rise from 11 cents to 36 cents over a three week period, recorded by Goldsearch NL.¹⁹³ These exceptional price variations usually reflect a particular disclosure situation. On 6 February 1996, Goldsearch replied to an earlier query by ASX, following a share price rise from 6 cents, that there was no matter of importance to disclose, although the company was aware of trading in a large parcel of stock. A reply to another ASX query on 13 February reiterated this statement.

A more significant announcement to ASX on 23 February stated that a Heads of Agreement, formed with the Land Council, would facilitate further exploration by the company. As the share price continued to rise, ASX queried the company for a third time on 1 March. The company announced to ASX at 9.44am on 4 March, that it had entered into 'a Diamond Exploration Option Agreement with Ashton Mining Ltd'. At 9.45am the same morning, Goldsearch replied to the stock exchange's query saying that the company had no matters of importance to disclose other than the above announcement.

In this instance, it would seem that the company relied on the confidentiality 'carve-out' in listing rule 3.1.3(b) as the information concerned an incomplete proposal or negotiation. However, for the 'carve-out' to be an effective defence against an accusation of non-disclosure, the information must remain confidential under listing rule 3.1.2. After such consistent price increases, and three queries from ASX, such confidentiality must be in doubt.

Digicall Group Limited

The maximum price variation for the trading induced stocks in Table 1.1 occurred in the industrial sector. It was an increase of 311.99 per cent when adjusted by the All Ordinaries accumulation index. This maximum was the result of an unadjusted 314 per cent rise in the share price of Digicall

¹⁹³ Goldsearch NL is classified by ASX as a gold exploratory company and its market capitalisation at 31 December 1995 was \$3.07 million. In 1995-96, the company expanded its exploration for deposits of minerals and precious metals to include South Australia and the Northern Territory, in addition to areas in Western Australia. The company maintains a policy of developing exploration opportunities in co-operation with Aboriginal people who hold valid applications for native title. In July 1996, the company and the Central Land Council, on behalf of the traditional owners, jointly submitted an application for an exploration licence over an area near Mt Patricia in the Northern Territory. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list 31 December 1995; Goldsearch NL Annual Report 30 June 1996.

Group Limited,¹⁹⁴ from 36 cents to \$1.49 between 13 July and 20 November 1995. The price fluctuation was queried by ASX on 6 December 1995, following four earlier queries by the stock exchange, three of which concerned variations in the company's share price.¹⁹⁵

In response to the first query on 25 August 1995, Digicall announced on 29 August that they had, on the previous day, completed the acquisition of ten retail stores. In not announcing the acquisition before completion of an agreement, the company seems justified in relying on the incomplete proposal or negotiation 'carve-out'. It is possible that the price increase prior to the announcement was not due to a breach of the confidentiality rule in 3.1.2 or even to the market action of an astute investor. As the directors suggest, the price increases could be the result of significant buy orders from the US following the positive recommendations of three different brokers.

ASX again queried price variations in Digicall securities on 11 September, prior to the release on 13 September of the company's preliminary final report that 'showed a profit of \$129,000 against a prospectus forecast of a loss of \$235,272'. A third ASX query on 6 November received the response from the company's directors that they were unaware of any matters of importance that might affect Digicall's share price other than two brokers' reports. ASX required these reports to be forwarded to the stock exchange. However, on 23 November, Digicall announced that it was currently conducting a road show in the US where institutions and private client brokers had shown significant interest in the company. This trading interest could be in anticipation of the commencement of trading of the company's American Depository Receipts.

¹⁹⁴ Digicall Group Limited had a market capitalisation of \$60.03 million at 31 December 1995 and was classified by ASX as a miscellaneous service provider. The company's principal activity, following the acquisition of Digicall Limited on 30 June 1995, was the supply of mobile phones and related equipment, and the provision of airtime on the Vodaphone network. Trading was suspended in Digicall Group's securities on 13 September 1996 pending finalisation of discussions with Vodaphone Pty Limited concerning the rescheduling of the group's debt. Voluntary administrators were appointed to the Digicall Group of companies from that date. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list 31 December 1995; Digicall Group Limited Annual Report 30 June 1995 and announcements to ASX on 13 and 16 September 1996.

¹⁹⁵ The fourth query is coded in ASX Signal G list as a stock exchange query without a response. As this query was on the same date as the first trading induced query of Digicall's share price fluctuations, and as no hard copy evidence was found in the company file held by the Stock Exchange Collection, then it is possibly a duplication of the original query. For this reason it has been classified as a 'technical' query for the purpose of this study and is not included in the Table 1 analysis.

ASX seemed concerned at this point that the research reports received from three brokers contained data, statements and assumptions, which did not appear to have been released to the market. This long saga was concluded on 11 December when the company responded that Digicall Group had not provided any material information to the brokers that was not already in the public domain.

As discussed above, the final query by ASX concerned Digicall's share price fluctuations over a four month period from July to November 1995. This is the longest query period recorded for this study. The average ASX monitoring period, between the initial and the final price shown in the query letter, is 7.4 days.

Regression Analysis of Trading Induced Queries and ASX Indices

The share price movements and index variations are adjusted by the risk free rate. For example, the calculated average daily 90 day Treasury Note rate is subtracted from the company's percentage share price movement for the period. This adjusted share return is then regressed against the similarly adjusted return on the primary index, which is the index sub-group most closely related to the company's industry group (IndAAcc). A similar adjustment and regression is calculated for the share price movements and the changes in the market, as represented by the All Ordinaries accumulation index.

As the descriptive statistics in Table 1.1 confirm, many of the trading induced companies have strong index adjusted price rises but there are also stocks that recorded price falls greater than the industry group or the market. For this reason, the queried stocks in Table 1.2 are divided into those with adjusted price increases and those with adjusted price decreases.

It is anticipated that the results of the above calculations will confirm that the stock exchange is querying those companies with abnormal price movements. These are movements that are unexplained by industry events or overall market fluctuation. At the time of this study there was no reason to expect that the companies queried would be randomly selected by ASX.¹⁹⁶ There is also no attempt to identify those companies with abnormal price or volume movements that have not been targeted by a stock exchange query.

¹⁹⁶ Since this study the regulators have expanded the selection of companies to be queried. ASIC and ASX announced on 22 June 2000 that the Commission will contact a 'representative sample' of ASX listed entities to review aspects of their compliance with continuous disclosure obligations. *ASIC Media Release 00/268 28 June 2000.*

If a particular company has a large capitalisation, and is included in the specific industry index associated with that company, then for any fluctuation in share price one would expect a return on the share price to be explained by the corresponding weighting in the relevant primary industry index. The reason being, that a rise or fall in the index company's share price, as shown by the difference between **P1** and **P2** for the 187 trading induced queries in the sample, will alter the company's market capitalisation. For example, if this company is included in Group 1, the primary Gold index, then the company's altered market capitalisation will affect the total capitalisation of the selected gold stocks in that index group. Both share and accumulation indices of the industry group index will be affected by a price variation in the securities of a component company.

This dependency would weaken when the individual company's market capitalisation is dispersed among the approximately 320¹⁹⁷ stocks that made up the All Ordinaries index during this period. Many companies, particularly the small mining stocks that are included in this study, will have a low capitalisation or an infrequent trading pattern. As a result, these companies are not included in the wider indices, as they are not capitalised in the relevant industry Index A. This exclusion should indicate a weaker relationship between these excluded stocks and all the index groups.

All the results of company returns in Table 1.2 are highly statistically significant at less than one per cent. As anticipated, trading induced stocks with adjusted price rises, when regressed against the adjusted All Ordinaries accumulation index, have high excess returns of 44.89 per cent, while those with price falls record an overall negative return of 26.18 per cent. In both cases, the market returns are not significant and give little explanation for these abnormal company returns.

This independent price movement is the reason these companies are queried by ASX. This is particularly evident in the mining sector where there is a positive adjusted return of 48.61 per cent (Adj Rsq 3.39%). The abnormal negative return for the ten companies queried for a price fall is almost as great, 40.05 per cent (Adj Rsq 46.52%). The small sample in this category could account for the greater explanatory power of the highly significant market return and the much higher adjusted *r*-square statistic.

The corresponding statistic for the 19 adjusted industrial price falls is more moderate (Adj Rsq 15.45%) for a negative company return of 22.7 per cent. The positive adjusted returns for the

¹⁹⁷ The number of companies included in the All Ordinaries index at 31 December 1995 (source: ASX *Fact Book 1996*, note 189 at 3).

industrial companies are not as extreme as the trading induced mining stocks, but they are sufficiently strong and independent at 41.15 per cent (Adj Rsq -1.39%) to warrant an ASX query.

Such abnormal returns support the supposition that these stocks could be trading on the basis of specific information that is not affecting the rest of the industry or the market. There is no great alteration to the results when the adjusted primary accumulation index, rather than the All Ordinaries accumulation index, is used in the regression.

Analysis of Total Sample

Monthly Price and Volume Data

In the trading induced queries analysed above, the initial and final price for the monitoring period was obtained from ASX's query letter to the company. However, an analysis of the total sample also requires share price and volume data for the technical queries. Price fluctuations were not the issue when ASX queried a company concerning a technical matter and, as a result, were not included in the query notice. To maintain uniformity for analysis of the total sample, monthly price and volume data were obtained from the *ASX Journal*.

In a previous event study, also associated with amendments to the *Corporations Act*,¹⁹⁸ Brown and Foo used monthly stock returns because of the thin daily trading pattern of the smaller listed companies. In this analysis, the event month was that in which there was a change in the relevant interest held by a director in the company.¹⁹⁹ Brown *et al*, in the CASAC (1996) report, analysed the effect of the s1001A/674 amendment by applying the All Ordinaries accumulation index to end of month share prices in order to calculate a company's market adjusted return.²⁰⁰

¹⁹⁸ Brown P and MS Foo 'Insider Trading in Australia: Evidence from Directors' Trades' University of Western Australia (undated working paper). The study analysed the 1996 trading patterns of directors in the shares of their own companies following amendments to s235 (CLERPA, note 59, s205G). (See section on Insider Trading in Chapter 5.)

¹⁹⁹ Ibid, Brown and Foo at 6, 7: Twelve monthly observations, encompassing the period before and after the event, were used in this study.

²⁰⁰ CASAC (1996), note 26 Appendix 9 at 9: Twelve separate monthly observations were generally used in this study.

In another legal context, Harris and Ramsay²⁰¹ conducted event study research to analyse the share price effect of a change in the interpretation of legal title. This study calculated the effects of the *Mabo*²⁰² decision on selected mining companies using an 11 day event window, or alternatively shorter event windows of three days. The study found that the length of the event window did not substantially affect the results.²⁰³

The analysis of trading induced queries in Tables 1.1, 1.2 considers specific price fluctuations that were queried by ASX, those between **D1** and **D2** for the 187 queries designated as trading induced. In Tables 2 and 3, adjusted variations in share prices, for the total sample of 427 queries made by ASX during the period of the study, are analysed over three separate time periods. The results for the three time periods are discussed in detail in the following paragraphs. Briefly, the three periods are designated as:

- Prior to Mid, variations in share prices and indices between the prior date and the mid date
- Mid to Post, variations in share prices and indices between the mid date and the post date
- Prior to Post, variations in share prices and indices for the total period between the prior date and the post date.

The descriptive statistics are further divided according to the index used to adjust the share price. For example, Table 2.1 records statistics for share prices adjusted by the appropriate primary accumulation index (IndexAAcc) of each of the queried companies, according to industry sectors, for the three time periods. Similarly, Table 2.2 contains descriptive statistics for the share prices of all queried companies adjusted by the wider market index, the ASX All Ordinaries accumulation index.

Table 3.1 analyses the relationship between changes in the share price and the All Ordinaries accumulation index for queries in the prior to mid period. Tables 3.2 and 3.3 contain similar regression analyses for the mid to post and the prior to post time periods respectively. Both variables in these three tables are adjusted by the average risk free rate for the relevant time period, as discussed in the earlier section on *Regression Analysis*. In Table 1.2, the trading induced queries were categorised according to adjusted price increase or price decrease and this practice continues in Table 3. As an abnormal rise or fall in the company's share price is not the basis of an ASX technical query, these are categorised only as mining or industrial.

²⁰¹ Harris and Ramsay, note 178 at 128.

²⁰² *Mabo v Queensland (No 2)*, note 179.

²⁰³ Harris and Ramsay, note 178 at 129 refer to n48.

Where required, all monthly share prices have been adjusted for changes in the basis of capitalisation to accommodate rights issues, entitlement issues and capital reconstructions. Alterations of more than one percent to a company's issued number of shares between the prior date and the post date have been checked and, if necessary, the share prices have been adjusted. No bonus issues were recorded for the sample companies during the period of the study.

Monthly share prices for the company that was formerly known as David Jones Limited were excluded from the Analysis of the Total Sample Queries in Tables 2 and 3. The company changed its name to DJL Limited on 9 October 1995, just prior to the public float of its main asset the David Jones retail stores. Insufficient information was available to adequately adjust the share price of the old entity following the public float.

Prior to Mid Regression Analysis (see Table 3.1)

Table 3.1 analyses the adjusted movement of a company's share price between a date prior to the event of an ASX query and a mid-point date. This mid date occurs between the prior date and the post date. The prior date, for those queries designated as trading induced, is the end of the month prior to the first date monitored by ASX for an unexplained variation in the price of the company's securities (**D1**) as indicated in the query notice.

As there is no **D1** for technical queries, the prior date for these technical queries is the end of the month prior to the query date. For calculating the prior date, the query date acts as a proxy for **D1** in the technical section of the sample. ASX queried these companies over some technical matter, usually concerning listing rules other than listing rule 3.1, and not because of an unexplained variation in the share price or trading volume between specific dates. Consequently, there is no **D1** or **D2** for technical queries. The prior price is the last sale price of the company's securities at the prior date. The price used is that of the company's ordinary shares. The end of month market share price for a company was obtained from the tables in the monthly *ASX Journal*.²⁰⁴

²⁰⁴ If **D1**, for the trading induced stocks, and the query date for the technical stocks, falls on or after the 15th day of the event month, then the last sale share price and indices for the prior month are recorded. If **D1** or query date falls before the 15th day of the event month, then the last sale share price and closing indices of the month before the prior month are recorded. As a result, the prior share price and indices could be a maximum of 44 days or a minimum of 15 days prior to the event. The average number of days for the 427 queries, based on a standard 30 day month including non-trading days, is 29.9 days before either **D1** or the query date. The average time period between **D1** and **D2** in a trading induced query is 7.4 days.

The mid price and indices are recorded at the end of the month that falls between the prior date and the post date. With one exception,²⁰⁵ the mid date is the end of the month following the prior date. The query date is the date ASX sends the query letter to the company. In 61.6 per cent of queries, the mid date occurs on or before the query date and in 38.4 per cent of instances the mid date is after the ASX query date.²⁰⁶

In an analysis of adjusted variations of stock prices from the prior date to the mid date, a stronger relationship would be anticipated between the market indices and the companies that received technical queries, than between the market indices and the trading induced stocks. A trading induced stock might move more independently of the market, even before ASX monitors its share price fluctuations. Investor anticipation of some future disclosure by the company could induce such a price movement. These anticipatory market adjusted returns could flow from a failure of corporate confidentiality or the deductions of an astute investor.

The *t*-statistics in Table 3.1, for the prior to mid period, indicate that results for all sectors of the total sample, with the exception of the technical industrial category, are statistically significant at less than one per cent. The highly significant adjusted positive returns for the trading induced queries support the finding of abnormal price rises over the shorter monitoring period recorded in Table 1.2. During the ASX monitoring period (Table 1.2), trading induced mining stocks returned a price gain of 48.61 per cent (Adj Rsq 3.39%) and a strong 33.66 per cent return (Adj Rsq -1.03%) for the prior to mid period (Table 3.1). The returns for the trading induced industrial category follow a similar pattern for both time periods, 41.15 per cent (Adj Rsq -1.39%) for the monitoring period (Table 1.2) and 34.81 per cent (Adj Rsq 1.07%) for the prior to mid period (Table 3.1).

However the negative returns for the prior to mid period in Table 3.1 are much lower than those of the monitoring period in Table 1.2. In Table 3.1, the trading induced mining negative return was 6.17 per cent (Adj Rsq 2.53%) and the industrials declined by 14.94 per cent (Adj Rsq 3.41%). The corresponding adjusted price falls for the ASX monitoring period were 40.05 and 22.7 per cent respectively. Based on these results, it would be appropriate for ASX to issue a query at an earlier

²⁰⁵ The exception is Digicall Group Limited where the prior date is 31 May 1995 and the mid date is three months later at 31 August 1995. This duration is the result of the long period of price fluctuation being queried by ASX, from 36 cents on 13 July 1995 to \$1.49 on 20 November 1995.

²⁰⁶ Of the 427 queries in the sample, the mid date occurred before the query date in 247 instances and on the same date on 16 occasions. The mid date was after the query date in 164 instances.

stage to those companies with abnormal price increases. This would not be necessary for those with an abnormal price decline as Table 1.2 indicates that the greater price decline occurs in the ASX monitoring period.

If the Mt Kersey²⁰⁷ price fluctuation is excluded, the positive return for the technical mining stocks is 10.23 per cent and significant at less than one per cent (Table 3.1 Technical Mining XMTK). When the Mt Kersey abnormal price variation is included the results are similar, 11.93 per cent, and also highly significant. The corresponding adjusted market returns are very strong and highly significant for the technical mining and total technical sectors in all three time periods (Tables 3.1, 3.2 and 3.3).

These results for the prior to mid period suggest that for many of the stocks in the trading induced sector of the sample, independent share price movement begins a number of weeks before the companies are the subject of ASX monitoring. The exclusion of Mt Kersey Mining NL from the sample under analysis in Table 3.1, as discussed in more detail in the following sections, does not alter the significance of the results. (see Figures 3.1 and 3.2).

Prior to Mid Descriptive Statistics (see Tables 2.1 and 2.2)

The descriptive statistics of the queries for the prior to mid period contribute to the analysis of the results in Table 3.1 discussed above. As anticipated, there is little variation in the results whether the share prices are adjusted by the primary index (Table 2.1), or the wider market index (Table 2.2). The mining sector of trading induced queries records the highest average percentage share price movement, when adjusted by the All Ordinaries accumulation index (Table 2.2 Coy Mean 21.47%, Median 13.87%), but the range of share price movements is wider in the industrial group (Min - 54.44%, Max 163.76%).

Descriptive statistics for the prior to mid technical queries, and therefore the overall results for the sample, are dominated by a share price gain for Mt Kersey Mining NL of over 500 per cent. The background to this price rise is discussed more fully in the next section and also in the section on *Insider Trading Case Law* in Chapter 5. The mean and median of the total sample²⁰⁸ are largely unaffected by the Mt Kersey share price but the movement of the stock is obvious in the range of price variations. For this reason, Table 2.2 records a prior to mid decline in the trading induced

²⁰⁷ See later section on *Mt Kersey Mining NL*.

²⁰⁸ Figures 3.1 and 3.2.

sample, adjusted by the All Ordinaries accumulation index, of 54.44 per cent by International Media Management (Holdings) Limited,²⁰⁹ but a maximum price rise of 572.65 per cent in the technical sample. If Mt Kersey is excluded from the sample for this period, the maximum price rise is a more realistic 175.57 per cent recorded by the Australian Brewing and Hospitality Group Limited.²¹⁰

Mt Kersey Mining NL

The action taken in the Victorian Supreme Court²¹¹ concerning trading in Mt Kersey²¹² securities in late 1995 is discussed in Chapter 5, under the heading *Insider Trading Case Law*. The outstanding price variation for this prior to mid period is a 577 per cent unadjusted price increase for shares in Mt Kersey Mining NL from 48 cents to \$3.25 during the month of November 1995. At the end of August 1995, ASX queried the company for a minor price increase from 38 cents to 42 cents on relatively high turnover. At the time the company indicated only that a draft financial statement anticipating an operating loss would be released in mid September.

²⁰⁹ International Media Management (Holdings) Limited was classified by ASX as a miscellaneous industrial company. The company's market capitalisation at 31 December 1995 was \$18.57 million. When queried by ASX regarding a share price fall in February 1996, the company suggested that speculation in relation to a capital raising might be the explanation. In the following month, a small loss was reported for the half year to the end of December 1995. The Chairman of International Media concluded that 1995 had been a year of 'dynamic growth' for the company in the field of television home shopping in Australia and Asia Pacific. These opportunities in electronic retailing were developed through The Value Network (Australasia) Limited. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list 31 December 1995; International Media Management (Holdings) Limited Annual Report 30 June 1995.

²¹⁰ The Australian Brewing and Hospitality Group Limited was included by ASX in the tourism and leisure sector. The ASX query of 22 November 1995 is not available from the company's file. Therefore, for the purpose of this study the query is classified as 'technical'. The query was possibly in connection with the company's name change, which was approved by shareholders on 28 November and effective on the stock exchange on 6 December 1995. The new name of J. Boag & Son Limited is designed to represent the company's heritage and the core business of brewing Boag's beer. Sources: ASX Industry Classification and Market Capitalisation list 31 December 1995; company correspondence to ASX 29 and 30 November 1995.

²¹¹ *R v Evans and Doyle* Supreme Court of Victoria 15 November 1999.

²¹² Mt Kersey Mining NL was classified by ASX as a gold explorer and the company's market capitalisation at 31 December 1995 was \$191.38 million. The company's major tenement interests in 1995-96 were located in the Eastern Goldfields region of Western Australia. Mt Kersey was exploring for nickel and cobalt in this area. The company's Gindalbie nickel project was located adjacent to the Silver Swan project. Mining Project Investors Pty Ltd made an announcement on 20 November 1995, which outlined the discovery of a high grade nickel resource at the Silver Swan site north of Kalgoorlie. In 1996-97, nickel and gold exploration was continuing at Mt Kersey's Gindalbie tenements. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list 31 December 1995; Mt Kersey Mining NL Annual Report 30 June 1996 and 1997.

At 3.44pm on 20 November, ASX in Melbourne received a fax from the company stating that ‘the directors are not aware of any reason to warrant the current price rise in Mt Kersey Mining N.L. shares’. At 7.15pm the same day, there was an announcement regarding the proximity of Mt Kersey’s Gindalbie project to a high grade nickel discovery, made by Mining Project Investors Pty Ltd at Silver Swan in the Black Swan area. This was also announced on the 20 November. Signal G classified the Mt Kersey query as sub report code 1701, representing an ASX query other than a price query, rather than the price query code of 1702.

The circumstances surrounding this second Mt Kersey query illustrate another aspect of the continuous disclosure rule. It is not incumbent on directors of a listed company to pre-empt an announcement of another company. This is still the situation, in spite of astute investor or insider share buying in Mt Kersey causing noticeable price rises. As the Mt Kersey insider trading case before the Victorian Supreme Court in 1999 was unsuccessful, this matter remains to be addressed by the Courts or by the regulators.

In its announcement to ASX, Mt Kersey drew attention to its previous June and September 1995 quarterly reports. The June report, issued on the 31 July, could have contributed to market interest as it revealed material information concerning the Gindalbie site:

“A review of airborne magnetic data has identified two host rock sequences equivalent to those found adjacent to the Black Swan nickel deposit.”

The technical sample, excluding the Mt Kersey variation (XMTK), is shown for comparison in Tables 3.1, 3.2 and 3.3.

Mid to Post Regression Analysis (see Table 3.2)

The above prior to mid analysis is concerned with a company’s price movement for the period prior to **D1** or the query date, which is the point at which ASX first registered an interest in the price fluctuation or initiated a technical query. The mid to post date analysis concentrates on a later period and aims to evaluate whether the adjusted price movements decline in the period after an ASX query is made. Of particular interest is whether the shares of companies in receipt of trading induced queries will continue to show abnormal price movements unrelated to the market.

The results in Table 3.2 measure the relationship between the adjusted variation in the closing market indices, from the mid month to the post month, and the adjusted share price returns for the same

period. The post date²¹³ is the end of the month after the final date of a company's variation of price (**D2**) as indicated in an ASX query notice. If it is a technical query that is not concerned with a share price fluctuation, then the query date is used as a proxy for **D2**. On a few occasions this results in the post date falling at the end of the same month as the mid date. This only occurs because of a delay in ASX receiving a reply to the query. In these instances, the reply date is used instead of the query date to calculate the post date.

In the mid to post date regression analysis in Table 3.2, the *t*-statistics indicate that the results for the trading induced queries are highly statistically significant at less than one per cent. The results of the technical queries for this post period are not statistically significant. All adjusted *r*-square statistics are low, as the return on the adjusted market index is insufficient to explain the abnormal company returns. It is anticipated that once a company replies to a trading induced query, its price movements will be less independent and more likely to represent the concerns of the wider market groups.

However, both the trading induced mining positive returns and negative returns are greater in this period just before and after the ASX query is made, 48.87 per cent (Table 3.1, 33.66%) and -16.17 per cent (Table 3.1, -6.17%). The contrast is stronger in the mining categories as the trading induced industrial companies are less volatile and record similar strong returns in both periods, 37.53 per cent (Table 3.1, 34.81%) and -10.44 per cent (Table 3.1, -14.94%).

Mid to Post Descriptive Statistics (see Tables 2.1 and 2.2)

The average and median price movements of the total trading induced group, adjusted by the All Ordinaries accumulation index (see Table 2.2), are slightly higher than those of the earlier prior to mid period. In the mid to post period the mining group has an average of 26.22 per cent (Median 11.85%) above the market, compared with 21.47 per cent (Median 13.87%) for the earlier period. The later price movements are also stronger for the trading induced industrial sector, from 11.02 per cent (Median 4.54%) in the prior to mid period to 18.23 per cent (Median 7.28%) for the mid to post

²¹³ The post date is the end of the month after the final date of the company's share price fluctuation (**D2**) as indicated in an ASX query notice. If it is a technical query then the query date is used as a proxy for **D2**. If **D2**, for the trading induced stocks, and the query date for the technical stocks falls on or before the 15th day of the event month, then the last sale share price and indices for the event month (**PoD**) are recorded as the post price and indices. If the price at **D2** or query date falls after the 15th day of the event month, then the last sale price and indices of the month following the post month are recorded. As a result, the post price may be a maximum of 45 days or a minimum of 15 days after the event. The average number of days for the 427 queries, based on a standard 30 day month including non-trading days, is 30.4. The average time period between **D1** and **D2** in a trading induced query is 7.4 days.

period. Contrary to expectations, the size of the average adjusted price movement does not decline once the company's reply is released.

A few stocks again dominate the range of share price variations. The maximum price rise of 291.9 per cent, when adjusted by the All Ordinaries accumulation index (see Table 2.2), is recorded by Goldsearch NL and is discussed in the following section. Those companies that are the subject of ASX technical queries are not buoyed by similar rises and they provide a strong comparison to the continued above market fluctuations of the trading induced stocks.

Medians for the technical stocks are negative, although only slightly, but the largest price decline for the mid to post period is drawn from the trading induced mining sector. Jonson's Well Mining NL recorded this decline of 57.07 per cent when adjusted by the All Ordinaries accumulation index.²¹⁴ When queried by ASX concerning a fall in its share price in November 1995, the company replied that it was not about to announce any matters of importance.

Goldsearch NL

The maximum price movement for this mid to post period occurs in the trading induced mining subgroup. Goldsearch NL's share price fluctuated from 10 cents to 39 cents during the two month period February to March 1996, an unadjusted rise of 290 per cent (Table 2.2 Max 291.9%). This price rise in Goldsearch's securities has already been discussed in the context of the earlier analysis of trading induced queries.²¹⁵ Results for the mid to post period suggest that, in this instance, the share price did not retreat after ASX queried the stock. This upward movement in the share price of Goldsearch occurred at a time when its specific industry index, and the All Ordinaries, registered falls of three to four per cent.

Prior to Post Regression Analysis (see Table 3.3)

These results represent longer-term adjusted share price and index movements from the chosen prior date to a post date. The post date occurs after the query date and the date of the company's reply to

²¹⁴ Jonson's Well Mining NL is classified by ASX as a gold explorer. The company's market capitalisation at 31 December 1995 was \$75.25 million. Jonson's main activity is gold exploration at the Duketon Belt of the Eastern Goldfields of Western Australia. The company's interests were increased during 1995 by a number of farm in joint venture arrangements. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list 31 December 1995; Jonson's Well Mining NL Annual Report 30 June 1996.

²¹⁵ See previous section on *Goldsearch NL*.

ASX. In 378 of the 427 queries, there is a period of two months between the prior date and the post date. In the case of 48 queries, there is three months between the two dates. There is one exception, which has already been mentioned, Digicall Group Limited, where the post date occurs seven months after the prior date.²¹⁶

Once again, all adjusted company returns in the trading induced categories for this prior to post period are statistically significant at less than one per cent and adjusted *r*-square statistics are low (see Table 3.3). The positive returns for the trading induced mining and industrial categories are almost double the returns in the shorter prior to mid period, 66.07 per cent for mining (Table 3.1, 33.66%) and 57.6 per cent for the industrial returns (Table 3.1, 34.81%).

Those trading induced stocks queried by ASX for a price decline recorded further price falls over the longer period, but not to the same extent as the companies with a further price rise. Trading induced mining stocks declined by 24.24 per cent (Table 3.1, -6.17%) and the industrials by 16.46 per cent (Table 3.1, -14.94%). These results suggest that companies, queried by ASX for variations of share price, continue to exhibit returns that are different to the market index after the replies to the queries have been released by ASX.

The returns of the technical industrial sector are not significant in any of the time periods. The return for the technical mining sector is highly significant and similar to those for the prior to mid period, 12.35 per cent (Table 3.1, 11.93%). If Mt Kersey's share price is excluded, the adjusted excess company return is barely altered, 10.53 per cent (Table 3.1, 10.23%).

Prior to Post Descriptive Statistics (see Tables 2.1 and 2.2)

Goldsearch NL²¹⁷ is again an example as it records the maximum price movement for trading induced stocks adjusted by the All Ordinaries accumulation index, 455.19 per cent over a three month period to the end of March 1996 (see Table 2.2). If the Mt Kersey share price movement is excluded, then the Goldsearch price gain is also the maximum increase for the total sample in the longer prior to post period. Company specific information continued to affect Goldsearch's share price even after a reply had been sent to ASX.

²¹⁶ See previous section on *Digicall Group Limited*.

²¹⁷ See previous sections on *Goldsearch NL*.

As in the prior to mid period, variation in the share price of Mt Kersey Mining NL dominates the technical sector for the prior to post period. As Table 2.2 illustrates, the Mt Kersey price increase for the two month period to the end of December 1995 was an adjusted 559.59 per cent, compared with the gain of 572.65 per cent discussed previously in the results for the prior to mid period. The decline in Mt Kersey's share price in the last month, the mid to post period, points to likely market absorption of all the relevant information and less anticipation of new material information in the near future.

If Mt Kersey's share price is excluded, then the maximum adjusted price rise for the technical queries is 292.93 per cent recorded by the Australian Brewing and Hospitality Group Limited.²¹⁸ The lower range of price movements for the prior to post period is represented again by the decline in the All Ordinaries adjusted share price of Jonson's Well Mining NL (Table 2.2, Total Minimum -59.11%).²¹⁹

Summary of Analysis of Total Sample Share Price Movements

There is an obvious difference in the trading patterns of those stocks that received a trading induced query and those that were queried by ASX for a technical reason. In support of the contention that continuous disclosure regulation has proved ineffective, many stocks have shown abnormal trading patterns several weeks prior to the monitoring period that prompted an ASX trading induced query. The size, range and strength of the independent trading of this sector are apparent when comparisons are made with the sectors associated with technical queries.

ASX appears to be aware of those companies displaying an abnormal trading pattern but, in general, this pattern commenced earlier than the dates alluded to in the query notice. It would seem that stock exchange action could be taken earlier, particularly for price rises in the mining sector.

An unexpected feature of the results is that the size and volatility of the price increases for the trading induced stocks in the period after the information is disclosed to ASX. It is possible that this trading pattern results from disclosure of the reply to the query, or is in anticipation of the release of further relevant information.

²¹⁸ The Australian Brewing and Hospitality Group Limited, note 210.

²¹⁹ Jonson's Well Mining NL, note 214.

Volume Tests

In the following tests, the monthly trading volume of the queried stocks is analysed. Beaver,²²⁰ in a 1968 study, noted the relationship between price and volume tests. If new information is sufficiently material, it will induce a change to the decision-maker's behaviour and prompt trading in a company's securities. Regardless of whether this adjustment of portfolio involves the purchase or sale of shares, the outcome will be reflected in the volume of shares traded. Material information concerning a company is likely to increase the trading volume as portfolios are realigned. The new information induces a change in volume and indicates a lack of consensus by investors regarding the share price.

Beaver maintains that both volume and price variations are relevant to a study of information changes and share pricing. He concludes that changes in market expectations as a whole are revealed through tests of price variations, while volume tests represent changes in the expectations of those individual investors who trade the securities.²²¹

Volume Test 1 Descriptive Statistics (see Tables 4.1, 4.2 and 4.3)

In the first volume test, a change in a stock's monthly trading volume is calculated for the same three periods that were observed for the tests of price variation, the prior to mid period, mid to post period and the longer prior to post period. These volume variations for each period are then compared to changes in the total equity trading volume of the market for the same time periods.²²²

For the duration of the 12 month period of this study the daily average equity turnover volume on ASX rose from 194.4 million shares to 301 million, an increase of 55 per cent. This includes the earliest prior period of May 1995 to the last post period at the end of April 1996. The actual monthly volumes of equity shares traded on the market, the figures used for these tests, record an increase from 4472 million shares for the month of May 1995 to 5719.5 million shares for the month of April 1996,²²³ a gain of 28 per cent. The discrepancy between the daily average figures and the monthly

²²⁰ Beaver WH 'The Information Content of Annual Earnings Announcements' (1968) *Empirical Research in Accounting: Selected Studies* 67-92.

²²¹ Ibid, at 69.

²²² *Monthly Index Analysis*, note 172 at 23.

²²³ Ibid.

totals is explained by fewer trading days in December 1995 and April 1996 due to public holidays. However, total monthly market figures are used for comparison with the fluctuations in the monthly volumes of the various stocks, as these figures represent an identical number of trading days for the company's shares and the market.

The longer prior to post period²²⁴ returned an average of 260.99 per cent volume variation for the total sample of 427 stocks. In contrast, there was only an 8.13 per cent variation in market volume for the same period. The median variations are more representative as they accommodate the extreme volume trading of some of the stocks. The median for the total company sample was 57.57 per cent and market volume increased by 6.11 per cent. Figure 4 illustrates the contrast between the volume variation of the trading induced, the technical and the market sectors for the three periods.

The most noticeable volume changes occur in the trading induced sector, particularly the mining stocks. The prior to mid period records an average increase in the monthly volume of these mining companies of 571.61 per cent. This is largely attributable to a relatively small number of high volume stocks and the median provides a more representative rise of 62.86 per cent for the sector during this period.²²⁵

The median movement for the trading induced sector as a whole is 45.23 per cent for the prior to mid period and the size of these fluctuations is reduced to 30.88 per cent after the query.²²⁶ Unlike many of the share price movements observed earlier, volume changes decline a little after the reply to the query is made public. This decline is most pronounced for the technical queries, as there is no release of price sensitive information in the reply to maintain a high level of trading.

Summit Gold NL

The high volume stocks are led by Summit Gold NL,²²⁷ which recorded the greatest change in monthly volume for the total sample, a rise of 10,847 per cent over the prior to mid period.²²⁸ This

²²⁴ Table 4.3, Total Coy Mean and Median; Total Mkt Mean and Median.

²²⁵ Table 4.1, Trading Induced Mining Coy Mean and Coy Median.

²²⁶ Compare Total Trading Induced Coy Medians in Tables 4.1 and 4.2.

²²⁷ Summit Gold NL was classified by ASX as a mineral explorer and the company's market capitalisation at the 31 December 1995 was \$5.28 million. The company acknowledged that the February 1996 Federal Election result had proved a catalyst for a change in uranium mining policy in Australia. This ignited renewed interest in Summits's Valhalla deposits, located north of Mount Isa, in Queensland. The company is also involved in gold exploration in Western Australia and the South

trading activity prompted a query from ASX on 7 March 1996 concerning price and volume fluctuations in the company's securities. The stock's trading volume for January 1996 was 367 thousand shares, but volume rose to more than 40 million shares for the month of February 1996. In its reply, the company pointed to the substantial shareholder notices it had lodged on 22 February.

These notices should have alerted the market to a recent sale by Orion Resources NL of a 42 per cent interest in Summit Gold. The sale was made to a number of investors and this increased the liquidity and spread of the company's shares. The volume of trading in these securities subsequently declined over the period to the end of March 1996.

Wells Gold Corporation NL

The other extremely large increase in volume trading, 7,190 per cent, was recorded by Wells Gold Corporation NL²²⁹ in the prior to post period.²³⁰ The rise was from a low base of only 415 shares traded in November 1995. About 1,600 per cent of the volume increase occurred in December 1995, just prior to the issue of an ASX query to the company concerning price fluctuations of up to 59 per cent between 27 December 1995 and 2 January 1996.

Wells Gold replied that a meeting with an associate company was held in Kuala Lumpur on 29 and 30 December 1995. The purpose of the meeting was to finalise a gold project. As a result of the meeting, a decision was taken to fast track gold production. In this instance, the directors appear to have invoked a 'carve-out' to their obligations under listing rule 3.1. An exemption under listing rule 3.1.3(b) would make it unnecessary for the company to release prior information concerning the meeting as the 'information concerns an incomplete proposal or negotiation'. However, abnormal price and volume increases indicate that either confidentiality was not maintained within the

Island of New Zealand. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list at 31 December 1995; Summit Gold NL Annual Report 30 June 1996.

²²⁸ Table 4.1, Trading Induced Mining Coy Max.

²²⁹ Wells Gold Corporation NL was classified by ASX as a gold explorer and the company's market capitalisation at 31 December 1995 was \$4.24 million. In 1995-96, the company concentrated on the Raub gold mining joint venture in Malaysia. Wells Gold initiated a major exploration programme in Guinea, West Africa and made application for an exploration licence in Mali. The company also maintained active exploration at Yunndaga and the Mt Celia leases in Western Australia. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list at 31 December 1995; Wells Gold Corporation NL Annual Report 30 June 1996.

²³⁰ Table 4.3, Trading Induced Mining Coy Max.

company, which would be a failure to comply with listing rule 3.1.2, or an astute investor anticipated the outcome of the Kuala Lumpur meeting.

Volume Test 1 Regression Analysis (see Table 5)

The results, as shown in Table 5, are calculated using regression analysis of the following form:

$$V_i = \alpha + \beta V_m + \varepsilon$$

where V_i is the excess volume for the company, α is the intercept, βV_m is the sensitivity to market volume and ε is the error factor.

The results indicate the relationship between variations in the volumes of queried companies and variations in total market volumes. These results are mostly statistically significant, with a probability of less than one per cent. For the prior to mid period, results are highly significant for the four main categories with the exception of the trading induced mining, which has a significance of less than ten per cent. While the company volume return is strong, reflecting the trading of the high volume stocks discussed above, the results are not as significant as the positive share price return for the mining companies (Table 3.1). Accordingly, it seems that the ASX alerting systems that give rise to queries are more likely to be triggered by unusual price changes than unusual volume changes.

Company volume variations, compared to the market volume are also significant in the mid to post period. It is not surprising that the exception is the technical industrial sector where the results are not significant. The share price returns of industrial companies subject to technical queries are also not significant in Tables 3.1 to 3.3, as it is unlikely that any price sensitive information is expected in the company's reply to the ASX query.

Company volume returns for the overall prior to post period are strong, particularly for the trading induced mining sector. Excluding the technical industrial companies, the results are highly significant and in accord with the abnormal share price returns in Table 3.3. The analysis in Table 5 reveals that the period before the query and reply, and the period after, both have a similar volume trading pattern for those companies queried by ASX.

Volume Test 2 (see Tables 6 and 7)

The second volume test is designed to isolate those stocks that might have shown abnormal variations in the trading volume of a particular month compared to the average monthly trading volume of the company's securities. If the results indicate that a variation in volume occurred in the prior period,

rather than a period after ASX queried the company, then the possibility exists that the increased trading is based on undisclosed material information.

The actual trading volume for a company's prior month, mid month and post month is sequentially compared to the company's average trading volume for the year. The average monthly volume of the company for the 12 months to December 1995 is used as a basis for the ratio. This figure is included in the monthly tables of the *ASX Journal*. For seven of the queries, concerning four companies,²³¹ the average monthly volume at the end of November 1995 or March 1996 is used. This alternative was necessary if the company was not listed or traded in 1995 or if there was a major reconstruction of capital.

The influence of the high volume stocks is apparent in Table 6. The means of the ratios of all groups, and for all three periods, are more than one. This suggests a greater level of above average trading in a company's securities occurs both before and after an ASX query. However, reliance on the median eliminates the influence of the high volume stocks. The median for the total sample indicates that a company's trading volume, for the month prior to a query notice, is 94.63 per cent of the company's average trading volume for the year 1995. The median is 136.70 per cent of the annual average trading volume for the mid month and an even stronger 147.34 per cent in the post month.²³²

These results contradict expectations, particularly for the trading induced stocks, that above average trading activity would occur more than two weeks prior to an ASX query. It appears that trading activity in all stocks is stronger near the mid month, either just prior to, or around the time of, the stock exchange query, and it is strongest in the month after the query.

One possible explanation for the lower volume ratio of the trading induced stocks in the earlier period, is that the company in question has requested a trading halt prior to the release of its reply to ASX. Alternatively, as a trading halt will only be effective for a limited time, ASX has imposed a temporary suspension of trading in the company's securities. This action is probable if a satisfactory

²³¹ An average monthly volume to November 1995 is used for GME Resources NL and Preston Resources NL, while a March 1996 average is used for Kanowna Consolidated Gold Mines NL and Trans-Global Resources NL. The February 1996 monthly volume data were deleted for two queries of Gindalbie Gold NL, as the reported volume appeared incorrect. ASX queried the company on 22 March as 'approximately 32 per cent of the company's ordinary shares had been traded in the last month'. However, the *ASX Journal*, note 182, February volume turnover was 23 million shares, which was more than the 21 million shares on issue at that time. While this is technically possible, it is unlikely given the figure quoted in the ASX query and a March volume of only 7.4 million shares.

²³² Compare Total Medians in Table 6.

reply to the stock exchange query has not yet been received. Both a trading halt and a temporary suspension would have artificially depressed the prior month trading volume. Information concerning the extent of trading halts, or the duration of suspensions, was not available for this study. Discussion on the technical aspects of this issue was included earlier in this chapter in the section on *Trading Halt*.

A *t*-test, paired two sample for means, is used to evaluate the relationship between the volume ratios for the three periods (Table 7). The number of companies included in any particular category of the total sample differs from those in Table 6, as some observations were not available in both periods of comparison.²³³ The results are only significant for the prior to mid and longer prior to post periods (Table 7). The means of the ratios of trading induced stocks, and to a lesser extent the technical mining sector, are statistically significant and negative for these two periods. There is a negative *t*-statistic, as the prior mean variable is significantly lower than the mid mean variable or the post mean variable. This confirms that there is higher volume trading around the mid period, just before or after the ASX query.

Results are not statistically significant for any association between the volume ratios of the mid month and post month. This could be due to a lack of independence in the volume samples, as both periods would reflect the companies trading pattern immediately before and after the release of the reply.

The results for industrial companies in receipt of technical queries are not statistically significant in any of the three time periods. Again a lack of independence in the monthly volume ratios is not unexpected as the technical information, requested by ASX and supplied in the company's reply, is likely to be non-price or volume sensitive and produces a stable trading pattern in the comparative months.

These results should be treated with caution as the monthly volumes of queried companies could demonstrate the influence of greater total market turnover. With the exception of the December quarter, there is a consistent rise in total equity trading during 1995 and the first half of 1996. The daily average of the total equity trading volume for February 1996 was 293.5 million shares, a 54.6

²³³ See also previous section on *Sample* and Column 2 of Table 14.

per cent increase on the daily average volume for February 1995 and a 41.7 per cent rise on the daily average volume for all of 1995.²³⁴

Summit Gold NL and Goldsearch NL

The maximums of the ratios for the mid and post months record inordinately high monthly turnover volume to 1995 average volume for two companies, Summit Gold NL and Goldsearch NL. In the mid month, Summit traded 6741.28 per cent²³⁵ of its 1995 average volume and Goldsearch traded 2572.88 per cent of its average volume for 1995. Both these ratios are based on February 1996 monthly volumes and are the result of changes to substantial shareholdings in the companies. As already discussed, in addition to specific circumstances, trading activity in individual stocks could be influenced by the strong overall market volumes in early 1996.

Cluff Resources Pacific NL

Cluff Resources Pacific NL²³⁶ was the recipient of a technical query from ASX concerning its high turnover in April 1996. The directors of the company became aware of sales of two substantial shareholdings and requested a suspension of trading before the market opened on the morning of 4 April 1996. ASX denied this request as it considered a suspension inappropriate at that time. By early afternoon, the directors had received unconfirmed reports that more than ten per cent of the company's share capital had been acquired by an investor who wished to have two directors appointed to the board. Cluff's directors refused to make these appointments, but a few days later they appointed two other new directors to the board. Cluff's monthly turnover volume for April 1996 was 3049 per cent²³⁷ of its 1995 average volume and the company's volume liquidity ratio in that month reveals that 30 per cent of the issued capital was traded.

²³⁴ *Monthly Index Analysis*, note 172 at 23.

²³⁵ Table 6, Mid Month, Trading Induced Mining Max. Summit Gold NL and Goldsearch NL were also discussed previously.

²³⁶ Cluff Resources Pacific NL was classified by ASX as a mineral explorer and the company's market capitalisation at 31 December 1995 was \$2.36 million. In 1996, the company focused its activities on the Copeton diamond project at Mount Ross NSW. This consolidation of activities at Copeton and Bingara diamond fields involved the sale of other mineral interests. The company had identified, and planned to mine, an inferred resource of over 500,000 carats of diamonds. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list at 31 December 1995; Cluff Resources Pacific NL Annual Report 31 December 1995 and Prospectus dated 10 October 1996.

²³⁷ Table 6, Post Month, Technical Mining Max.

Volume Test 3 (see Tables 8 and 9)

Volume liquidity is the subject of a further test to ascertain whether trading volume for a stock is higher in the period prior to a company's receipt of an ASX query letter. If the volume turnover in the company's securities is higher, it could indicate either astute investor trading, pending the company's reply to the query, or a lack of confidentiality on the part of the company at least two weeks prior to the reply.

The volume liquidity²³⁸ figure in these tables is measured as the proportion of a company's issued number of shares that traded in each of the prior, mid and post months. It is calculated as the ratio of a company's actual trading volume for the month to the issued number of shares that the company had listed on ASX at the end of that month. Unlisted shares and options are excluded.²³⁹ The association between these volume liquidity ratios are then compared, as in the earlier tests, for the prior and mid, mid and post and prior and post periods.

The total ASX market value liquidity figures for the calendar year 1995 and the financial year to the end of June 1996 were 43.6 per cent and 48.0 per cent respectively.²⁴⁰ The basis of this total market liquidity is the annualised average daily turnover value to average market capitalisation. If the medians in Table 8 are annualised, then the volume liquidity medians for the total sample are in accord with the market's value liquidity for the period.²⁴¹

Due to the absence of comparative observations for both time periods, the number of companies in each category of Table 9 differs from those in the descriptive statistics of Table 8. The results of the *t*-tests of the means of volume liquidity ratios in Volume Test 3 (Table 9) are similar to those of Volume Test 2 (Table 7). The *t*-statistics for the ratios of trading induced stocks, and to a lesser

²³⁸ "Prior research finds a positive relation between liquidity, proxied by average trading volume relative to shares outstanding, and the level of institutional ownership" in Bushee BJ 'Disclosure Quality, Institutional Investors and Stock Return Volatility' University of Sydney Accounting Foundation *Research Seminar Series* 25 March 1999 at 4.

²³⁹ The issued number of shares and the monthly volume figures were obtained from the SXJ tables in the monthly editions of the *ASX Journal*, note 182.

²⁴⁰ *Monthly Index Analysis*, note 172 at 22.

²⁴¹ Table 8 Prior Month Total Median (37.32%), Mid Month Total Median (51.36%) and Post month Total Median (56.52%).

extent the technical mining sector, are statistically significant and negative for the prior to mid and prior to post periods only. The liquidity ratios in the prior period are significantly lower than those in the mid or post periods, which supports the results in Volume Test 2 and concentrates the higher volume trading around the mid period for most queried companies.

T-tests in Volume Test 3 for the technical industrial queries in all periods and for the mid volume liquidity of all queries, are not statistically significant. Technical mining queries have a low significance only in the prior to mid period. As in Volume Test 2, these stocks tend to have similar trading patterns immediately before and after release of the reply.

Of interest in the volume trading analysis is the relevance of market related volume results for Volume Test 1 in Table 5, compared with the non-market related results for Volume Tests 2 and 3. In the latter results, company volumes are related to other characteristics of the company itself, the average annual volume or the number of shares on issue. The company volumes in these tables are not evaluated against the market volume, which like individual company trading was increasing in the later months of the study.

Amity Oil NL

Identical prior and mid maximum liquidity ratios of 53.31 per cent,²⁴² for the mining trading induced stocks, were recorded in November 1995. These ratios were associated with different queries of the same company, Amity Oil NL.²⁴³ In this instance, high liquidity could signal a lack of confidentiality by the company or the actions of astute investors. Amity was queried by ASX on 20 December 1995 regarding unexplained fluctuations of its share price during the month. The company replied at 11.14am on 21 December that there was no unannounced information that could explain the recent price increase. In this reply, the company suggested that a possible reason could be a research article, released by a Perth stockbroker on 12 December, which gave the stock a 'speculative buy'

²⁴² Table 8 Trading Induced Mining Max.

²⁴³ Amity Oil NL was classified by ASX as an oil and gas explorer. The company's market capitalisation at 31 December 1995 was \$37.34 million. In November 1995, Amity Oil made a significant gas discovery at the Wagon Creek 1 well in the north of Western Australia. As a result of this discovery, the company is committed to an accelerated appraisal programme and as part of its exploration strategy it purchased a drilling rig. In most of its other Australian interests, drilling is farmed out but Amity Oil retains majority equity. The company's drilling activity in the United States has been reduced in favour of exploration in Australia. Sources: *Industry Classification Report* July 1992, note 157; ASX Industry Classification and Market Capitalisation list at 31 December 1995; Amity Oil NL Annual Report 30 June 1995 and Prospectus dated 28 February 1996.

recommendation. Some hours later, on the afternoon of 21 December at 4.43pm, Amity Oil announced that they had reached agreement to purchase a drilling rig, which would give the company greater operational flexibility and reduce the cost of wells. The same reason was cited when the company was again queried by ASX for continued share price rises in early January 1996.

Analysis of Replies

As part of the data collection process, the reasons given by a company for its non-disclosure or its share price fluctuations were noted. This information was generally included in the company's reply to ASX, or gleaned from later announcements made by the company to the stock exchange. In many instances, the company stated that the market was 'fully informed' at the time of the reply to ASX. Many companies proposed the argument that the queried price fluctuations resulted from the amount of time taken by the market to digest information contained in earlier disclosures. This could be the case for many of the smaller companies, as they were probably not subject to regular analyst attention. When company disclosures are analysed soon after their release the market will more quickly absorb any share price effect flowing from the announcement.

Often price sensitive information is included in the company's reply to an ASX query, or in a disclosure made within a reasonable period after the reply date. This material information could be responsible for the earlier price variation, either through a lack of company confidentiality concerning the information or investor anticipation of the outcome of the reply. If it is the former situation, then the company has chosen to rely on one of the 'carve-outs' provided in listing rule 3.1 but has been unable to maintain absolute confidentiality. Some of the information might have been utilised by a person associated with the company or the information has been leaked, either consciously or carelessly, to market participants.

Reliance on confidential information often appears to result in market trading that produces a price fluctuation, which then becomes the subject of an ASX query. Such trading could come within the definition of 'insider trading' and result in a breach of s1002G/1043A. Astute trading, which is the result of deductions drawn from generally available information, is exonerated by s1001C(3)/676(3).

Trading based on information that is the subject of a confidentiality 'carve-out' conveys an alternate signal to the market that the company has material information that is not yet released. The fact that the market reacts to this information, which as yet is not in the public domain, is consistent with the efficient market hypothesis.

Previous analysis in this study was based on actual data collected for the 427 queries sent by ASX. Even the initial division of these queries, into trading induced and technical, was decided by ASX through the format used for the query. For it to be classified as a trading induced query, ASX must have asked a company for an explanation about stated price fluctuations. The queries were classified in this way by the stock exchange, but the replies were not.

Replies to ASX Queries (see Table 12)

The analysis of the replies in Table 12 is an attempt to complete this classification. A classification of the replies sent by companies to ASX makes it possible to discern situations where directors or management probably relied on a 'carve-out' to continuous disclosure. The same format is adopted, with queries classified as trading induced mining, trading induced industrial, technical mining or technical industrial.

Within this classification, replies are placed in one of five categories. As there is some overlap, it would be possible to reduce this number to four categories. Many of the technical queries relate to a failure by a company to provide the necessary detail required under ASX listing rules. This detail is considered necessary by the stock exchange in its endeavour to maintain a fully informed market place. However, as ASX has not instigated a trading induced query, the absence of this disclosure does not appear to have had an immediate impact on the share price of the queried company.

Listing Rule Queries (see Tables 12 and 13)

There were 144 listing rule queries, 99 of which were to mining companies and 45 to industrial companies. In 40 of these queries, ASX did not quote the precise rule that was the basis of its demand for further information. For example, a stock exchange query often cited the annual report or the quarterly mining report received from a company and requested additional details. Also, in some instances a listing rule could be cited in connection with a trading induced query. This explains the discrepancy between the 144 queries in the Listing Rules category in Table 12 and the 168 listing rule citations in Table 13.

In 44 instances, technical queries were concerned with the 'competent person statement' required under listing rule 3M(7) and 3M(8).²⁴⁴ Current equivalents of these rules, introduced under the 1996 revision of the *ASX Listing Rules*, are rules 5.10 to 5.13. The rules demand that a report relating to a

²⁴⁴ Table 13, 3M mining reports.

company's mineral resources must contain a statement by the competent person who has compiled the information in the report. The report must state whether the competent person is a full time employee of the company. If this is not the case then the name of the competent person's firm must be given together with the person's written consent for inclusion of the information in the report. The rule is a guard against the possibility of a mining company issuing a sham or unsubstantiated geological report.

The Perth branch of ASX, having the greatest interest in these exploratory mining companies, was particularly diligent in following up incomplete 3M(7) statements. All but four of the 44 queries concerning these statements emanated from Perth. Three queries were from ASX in Sydney and one was from Melbourne. As all the queried companies complied with the ASX request for 'competent person' statements, it is unlikely that this group of mining queries would be price sensitive in any way.

'Nil' Queries

For completeness, 20 'nil' queries are included in the total sample of 427. These queries of specific companies, and the date on which they occurred, are listed in ASX Signal G data obtained by Professor Brown for the CASAC (1996) *Report on Continuous Disclosure*. With the exception of two Perth queries, which have no accompanying replies, there is no evidence of the queries in the files held at University of Sydney's Stock Exchange Collection. It is possible that some of these 'nil' queries were telephone inquiries. Alternatively, records of the queries might not have been transferred from the Companies section of the relevant branch of ASX to the files of ASX Sydney, which form the basis of the Stock Exchange Collection. Two of the 'nil' queries emanated from ASX Perth as this fact is acknowledged in later correspondence found in the company files. As so little information is available for these 'nil' queries they are designated as technical rather than trading induced.

'Fully Informed'

To consign a query to one of the remaining three categories required a degree of judgement that had not previously been exercised in this study. Classification of the replies is based on the explanation for non-disclosure sent by the company to the stock exchange. Most of the queries in these categories are trading induced and the majority, although not by a great margin, are mining companies.²⁴⁵

²⁴⁵ Table 12. There are 99 trading induced (59 mining, 40 industrial) and 44 technical queries, 22 each of mining and industrial companies.

There are 143 replies in which the companies forwarded an adequate explanation for the price fluctuations of their shares. Often the reasons are a reaction to a market situation. Examples are the trading in Ampol Exploration shares prior to the Mobil takeover offer, or price movements prior to the release of a substantial shareholder announcement. In many of these situations, price changes are initiated by information external to the company. Directors could not reasonably be expected to make an announcement until they were provided with this external information. For whatever reason, a lack of confidentiality by a source external to the company or just speculative investment, the market anticipated a price sensitive announcement.

Many companies suggested that price fluctuations could be a reaction to information that had been previously placed in the public domain. Time delays in the absorption of quarterly or interim announcement details, or the circulation of broker recommendations were other reasons offered. In two cases, time zone differences were relevant as a company released an announcement to ASX Sydney just prior to queries being issued by ASX Perth.²⁴⁶ In 143 instances, the company maintained that the market was ‘fully informed’ and that the directors had offered reasonable explanations for this statement. From the replies to ASX, it appears that company directors do not admit there are ‘any matters of importance concerning the company about to be announced to shareholders and the market’.²⁴⁷ It is difficult to assume from these statements that the directors are relying on disclosure ‘carve-outs’.

Qualified ‘Fully Informed’

The remaining 120 queries, a little more than a quarter of the total sample of 427 queries, provide a clue to those companies that could be relying on ‘carve-outs’ to listing rule 3.1. Once again, most of these replies are related to trading induced queries. For the purposes of this study, the queries are separated into two groups but, in reality, these could be combined to form one group where the companies’ replies seem questionable in some way. The first group comprises those replies where there is some qualification to the ‘fully informed’ label.

In many of the 48 ‘qualified fully informed’ replies, the company states that:

²⁴⁶ This situation occurred with Crest Resources Australia NL on 24 August 1995 and Duketon Goldfields NL on the 31 August 1995.

²⁴⁷ This is usually the first question of the standard format query sent by ASX Perth, eg Abador Gold NL correspondence of 7 February 1996.

“...there is no specific material information to disclose but...”.

This ‘but’ is usually followed by specific information associated with the company, which the market appears to have already found to be material, even if management of the company does not acknowledge that earlier disclosure could be warranted. In the remaining instances, the reply states that the market is fully informed. At a later date, which is sometimes the following day, the company releases information that is price sensitive and likely to be material to any query of price fluctuations. In these situations, the market would benefit from earlier release of the information, or at least an announcement that information is pending.

Incomplete Proposals

There is an ambiguity in the previous group of replies designated as ‘qualified fully informed’. Is the company consciously relying on one of the ‘carve-outs’, or is it just tardy or uncooperative in complying with the disclosure rule and informing the stock exchange? This final group of 72 ‘incomplete proposal’ replies has similarities to the previous group. The market has not been kept fully informed of all information that would be expected to have a material effect of the price of the company’s shares. However, for replies in this category there is no ambiguity. The companies in this situation are clearly relying on the ‘carve-out’ in listing rule 3.1.3(b) that:

“...the information concerns an incomplete proposal or negotiation”.

Of these 72 ‘incomplete proposal’ replies, 52 are for trading induced queries. In many instances the company is involved in negotiations for contracts, share placements or joint venture agreements. In other cases the company is awaiting an expert’s report, drill results or approvals of some kind. The common thread in the replies is that the company does not feel constrained by s1001A/674 to disclose information to the market at the time of the ASX query. However, in at least the 52 trading induced queries, it seems that some information has been available to the market. Sufficient information concerning an incomplete proposal was present to form a probable basis for the company’s share price fluctuation. This implies a breach of the confidentiality requirement of listing rule 3.1.2.

Price Rises and Falls (see Table 14)

Responses to ASX queries are not in the standard form of a profit announcement similar to periodic half-yearly and preliminary final reports. For this reason, it is not possible to definitively allocate replies to either ‘good news’ or ‘bad news’ categories. It is only possible to register whether the market’s anticipation of, or reaction to, an announcement is either positive or negative. Table 14

indicates that more than half of all queried stocks registered a price rise during the three time periods of this study.

The number of price rises, compared with price falls, is slightly higher for those companies receiving trading induced queries. The total percentage of rises is reduced by about ten per cent when the price fluctuations are adjusted by the All Ordinaries accumulation index. However, this adjustment serves to accentuate the greater number of price rises occurring in the trading induced sector.

Evaluation of Results

As discussed in Chapter 2 under *ASX Listing Rules* and 'Carve-Outs', a company must not rely on the exemptions to disclosure in listing rule 3.1 unless the following conditions are met:

- a reasonable person would not expect the information to be disclosed, and
- the confidentiality of the information is maintained.

If the company does not disclose the material information, but is unable to keep it confidential, then s1001A/674 may be considered ineffective in its aim to enforce listing rule 3.1 and maintain a fully informed market.

In this study, the 427 queries made by ASX to listed companies were analysed in order to ascertain if company officers relied on 'carve-outs' in instances where confidentiality of material information was not contained with the company. A clarification and analysis of this problem involved the following procedures:

- analysis of those queries that were trading induced,
- analysis of the total sample and
- analysis of the replies.

The first issue was to isolate those instances where an ASX query to a company was induced by an abnormal trading pattern in that company's securities. These were termed 'trading induced' queries and were differentiated from those companies that received a technical query, where the reply was not expected to contain information that would be immediately price sensitive.

The trading induced queries illustrated the stock exchange's surveillance of a company's suspected abnormal trading pattern prior to the query. The maximum movement in the share price, when adjusted by the relevant indices, and the dates between which it occurred were monitored. If these

adjusted price fluctuations had proved to be low to moderate, between five and ten per cent, or even as high as 20 per cent, there would have been little incentive to pursue a statistical study.

However, as Table 1.1 illustrates, the industrial companies targeted by ASX registered adjusted price variations of 25 per cent and the mining companies of approximately 40 per cent. Not only were there large price movements in the mining stocks, the excess returns²⁴⁸ on this trading were statistically significantly different to the adjusted returns of the mining indices. The trading induced mining segment continued to be the most susceptible to large variations of share price and volume.

The first of the three issues listed above was to analyse the 187 trading induced queries from the point of view of the stock exchange. To observe the price movement during the period monitored by ASX and, after adjusting for the relevant industry or market indices, to verify that ASX was justified in forwarding a trading induced query to the company. Each stock was analysed for the ASX monitoring period only. Having ascertained that ASX's trading induced queries were successfully targeting those stocks with unexplained price movements, the study could progress to the next stage.

In this second stage, the total sample of 427 stocks, recipients of both trading induced and technical queries, was analysed. The analysis was extended to include the periods before and after the ASX query was issued, on average a total period of two to three months. The price and volume information was not the result of an ASX monitoring process but was extracted from monthly data in the *ASX Journal*.

The value of this second stage analysis is that it offers a basis of comparison, between the adjusted prices of those stocks that received a query that was trading induced and those that received a technical query from ASX. The focus of the study is the trading induced stocks and these could have been matched, for comparative purposes, with companies of similar size and industry that had not received an ASX query for further disclosure. If this had been the basis of comparison, then a strong contrast would be expected between the results for the trading induced queries and the matched companies without queries. However, the current study shows that there is still a sufficiently strong contrast between the results for the trading induced queries, subdivided according to a price rise or price fall, and the technical queries to validate this choice of comparison.

²⁴⁸ Table 1.2, Trading Induced Mining (Price Increase 49.04%, Price Decrease -34.56%).

As anticipated, the market adjusted price movements²⁴⁹ of the trading induced stocks are much greater than those of the technically queried companies both before and after the query date. More particularly, the emphasis continues to be on the greater abnormal price variations of the trading induced mining segment in both periods. The average market adjusted price movement for this mining segment was a strong 21 per cent in the period prior to the query, and an even stronger 26 per cent in the weeks after the query. This is an average above market return for the prior to post period of more than 54 per cent.

Although the stock prices in the mining segment reacted prior to the ASX query, on the basis of astute investor or insider trading, there was still additional information to be absorbed by the market. The fact that price movements indicate further adaptation once the company's reply to ASX is disclosed is in accord with the semi-strong form of the efficient market hypothesis.

For the mining segment of the trading induced queries there is a very independent trading pattern both before the ASX query and after the company's reply.²⁵⁰ The company's share price does not quickly return to moving with the market once the disclosure has been made to the public.

This continued price variation probably represents the ongoing expectations of investors. For example, investors anticipate the release of additional information concerning forthcoming contracts or leases, clarification of mining reports or changed profitability. Alternatively, the share prices of some of the less liquid stocks will take longer to fully absorb the information contained in the company's reply.

The volume tests are twofold. Initially the volume movements of the queried stocks are compared to the volume movements of the market. The descriptive statistics confirm that the median volume variations for the trading induced stocks are consistently much higher than the overall variation of the market volume for the periods prior to and after the query. Once again the strongest median volume movements occur in the mining segment of the trading induced queries.²⁵¹

The remaining volume tests are introspective and compare the company's volume trading pattern to its own benchmarks rather than those of the market. A company's monthly trading volume is

²⁴⁹ Table 2.2, Prior to Post Trading Induced Mining Coy Mean.

²⁵⁰ Tables 3.1 and 3.2, Trading Induced Mining.

²⁵¹ Tables 4.1, Trading Induced Mining Coy Median.

compared to its average monthly volume and then to the number of shares on issue at the end of the month. The ratios suggest that, for all segments of the queries, there is higher mean and median trading volume at the end of the mid and post months, than at the end of the month prior to the query.²⁵² The relationship between the volume liquidity ratios for the different periods supports this and again the focus is on the mining segment of the trading induced queries.

The end of the mid month occurs just before or at the query date for 62 per cent of the sample, and just after for the remainder. The conclusion indicated by this is that volume is stronger around the query date and even stronger at the post date after the reply is received. This does not conflict with the earlier tests of the price fluctuations. However, if the assumption is made that large volume and price movements are likely to occur at the same time, then the maximum trading activity probably takes place in ASX's average monitoring period. This period would be the week, rather than the month, prior to the query.

An interpretation of replies submitted to ASX in response to a query occupies the final stage of the study. The majority of companies received technical queries and most of these replies could be considered satisfactory. However, if the benefit of the doubt is extended to those responses with a genuine argument that the market is fully informed, then there still remains 20 per cent of all replies, which offer inadequate responses to a trading induced ASX query.²⁵³ This group consists of the 'qualified fully informed' and 'incomplete proposal' responses for the trading induced mining and industrial queries. These companies released potentially price sensitive information within a reasonable period after they were queried.

By admission or implication, these companies would appear to be relying on one of the 'carve-outs' to listing rule 3.1. It seems unlikely that price or volume variations for one in five of all queries could be attributed to astute investor trading based on deductions from 'generally available' information. In at least some instances, and possibly many, failure of the confidentiality requirement appears to have resulted in insider trading.

²⁵² Compare Tables 6 and 8, Total Mean, Median.

²⁵³ Table 12, the 20 per cent (52 Incomplete Proposals and 36 Qualified replies) rises to 28 per cent of the total sample if the technical queries are included (72 Incomplete Proposals and 48 Qualified replies).

Company Profile

The following profile emerges of the company most likely to be queried by ASX on a continuous disclosure issue. Either the Perth or Sydney branch of ASX initiates the query.²⁵⁴ A ‘trading induced’ query notice, requesting an explanation for a share price fluctuation, is directed to a mining company. The company’s adjusted share price has registered an increase of 40 per cent²⁵⁵ in the period monitored by the stock exchange between **D1** and **D2**, and approximately 20 per cent in the month before the ASX query.²⁵⁶ The excess returns on company trading are significantly different to the market returns.²⁵⁷ There is also a noticeable increase in the volume trading of some companies compared with overall market volume in the early period.²⁵⁸

In Chapter 6, some implications that arise as a result of this empirical research are explored in the context of disclosure law and policy.

²⁵⁴ Table 10.

²⁵⁵ Table 1.1, Trading Induced Mining P1P2-AllOrdAcc, Mean 40.98%, Median 38.61%.

²⁵⁶ Table 2.2, Prior to Mid Queries, Trading Induced Mining, Coy Mean 21.47%, Median 13.87%.

²⁵⁷ Table 3.1, Trading Induced Mining.

²⁵⁸ Table 4.1, Prior to Mid Monthly Volume, Trading Induced Mining Coy Median 62.86% and Mkt Median 10.51%.

CHAPTER 4

International Regulation

In a survey of six of Australia's major trading partners, Semaan, Freeman and Adams²⁵⁹ found that only Indonesia, India and Japan provided any statutory backing for stock exchange regulation of continuous disclosure. Hong Kong, United Kingdom (UK) and the US had a civil remedy for a breach of stock exchange rules. As the securities law of both the UK and the US have, at various stages, provided a guide for Australian regulators, they are the only regulatory regimes examined in detail. Disclosure regulation in Canada is also included in the discussion as it has similarities to the Australian system.

United Kingdom

General disclosure requirements are common in other jurisdictions. Under the London Stock Exchange (LSE) guidelines to continuing obligations, a listed company was required to notify the exchange without delay of 'all relevant information' that was not public knowledge and 'any major new developments in the company's sphere of activity' that could be price sensitive.²⁶⁰ Any change in the financial condition or expected performance of a listed company should be disclosed.

Effective 1 December 2001, these listing rules and their enforcement are no longer the responsibility of the LSE, which followed the ASX model and become a company listed on its own exchange. Shares in London Stock Exchange plc were listed on the main market on 20 July 2001.²⁶¹ The Financial Services Authority (FSA), as the single statutory market regulator under the *Financial Services and Markets Act 2000* (UK), now has responsibility for supervising the LSE. As a result, there is a 'two-stage admission process' for companies wishing to list securities in London: the company must apply to the UK Listing Authority (UKLA), a division of the FSA, for admission to

²⁵⁹ Semaan L, MA Freeman and MA Adams 'Is Insider Trading a Necessary Evil for Efficient Markets?: An International Comparative Analysis' (1999) 17 *Company and Securities Law Journal* 220-246 at 220, 237.

²⁶⁰ London Stock Exchange *Continuing Obligations Guide* (1999) Part 1 Disclosure of Price Sensitive Information Listing Rule 9.2, 9.2.

²⁶¹ London Stock Exchange *Interim Report - Six Months ended 30 September 2001* London 6 November 2001 1-13 at 3.

the Official List and then must apply to the LSE for admission to trading on the stock market.²⁶² The continuing obligations, discussed above, remain unchanged but are now contained in the listing rules of the UKLA.²⁶³ These obligations are also reinforced by the similar LSE disclosure standards 3.1 and 3.2.²⁶⁴

The UKLA declines to define the term ‘substantial movement’ as a standard of the materiality of the disclosure.²⁶⁵ This decision is in line with ASX policy. The LSE had previously stated that a ‘substantial movement of price’ cannot be measured by a formula such as a theoretical percentage change of share value in a given time period. It is sufficient that the information is price sensitive and has the potential to have a significant effect on the share price.²⁶⁶ The result was LSE reluctance to impose formal sanctions on a company for a failure to disclose. The normal penalty for non-disclosure remains a suspension of trading in the company’s securities.²⁶⁷

The enforcement²⁶⁸ powers of the UKLA are potentially stronger than those of the LSE. If a company has breached any provision of the listing rules, then the Authority can impose a financial penalty or publish a statement censuring the company ‘subject to the provisions of the Act’.²⁶⁹ Similar penalties apply to a director who is knowingly concerned in the breach. This UK example could strengthen ASIC’s call for the right to impose fines on companies for market offences.²⁷⁰

²⁶² Financial Services Authority *Introduction to the Financial Services Authority* London 1 December 2001 at 3, 14 and 15; London Stock Exchange *Admission and Disclosure Standards* May 2001 at 1.1.

²⁶³ UK Listing Authority *Listing Rules* 1 December 2001 Chapter 9 pars 9.1, 9.2.

²⁶⁴ *Admission and Disclosure Standards* May 2001, note 262 Part 2 at 3.1, 3.2.

²⁶⁵ UK Listing Authority *Guidance Manual* 1 December 2001 Appendix 3 Continuing Obligations Guide at 2.3.

²⁶⁶ Frost CA ‘Disclosure Policy Choices of UK Firms Receiving Modified Audit Reports’ (1997) 23 *Journal of Accounting and Economics* 163-187 at 166.

²⁶⁷ *Admission and Disclosure Standards* May 2001, note 262 Part 2 at 4.4 to 4.10.

²⁶⁸ Financial Services Authority *FSA Handbook of Rules and Guidance* Enforcement - Chapter 14 Sanctions for Market Abuse at 14.3, 14.7.

²⁶⁹ *Listing Rules* 1 December 2001, note 263 Chapter 1 pars 1.8, 1.9; *Financial Services and Markets Act 2000* (UK) ss123(1)(a), 123(1)(b).

²⁷⁰ *ASIC Media Release* 01/283 13 August 2001; Knott D ‘Launch of the Australasian Investor Relations Association’ Speech by the Chairman, ASIC 13 August 2001 at 3 and 4.

As in Australia, any impending strategic developments or ‘matters in the course of negotiation’ must be disclosed where there is reason to believe that a breach of confidentiality has or is likely to occur. There is emphasis in the UK on a warning announcement, even if the company is unsure whether there has been or is likely to be such a breach, it should at least issue a warning to the UKLA stating the accuracy, or otherwise, of potential leaked information. The company should issue the warning announcement if any hint of the undisclosed price sensitive information appears in a press article or in a share price movement.²⁷¹

These guidelines remind the recipients of confidential information that they may not deal in the company’s securities until the information is made public. There is a warning of the insider dealing provisions, contained in the *Criminal Justice Act 1993* (UK), which can apply to those who trade while in possession of undisclosed price sensitive information. The LSE model code still remains as an appendix to Chapter 16 of the UKLA listing rules. The purpose of the code is to ensure that directors and officers of a listed company do not trade in securities of that company while they are in possession of undisclosed price sensitive information. The code encompasses advisers and others who are closely connected with a company. If there is any matter that constitutes unpublished price sensitive information, then directors and officers must obtain the permission of the chairman, or other designated director of the company, before selling or purchasing shares in the company. The designated director must maintain a written record of any trading permission or refusal that is given. These are the minimum requirements of the code.²⁷²

United States

As is the case in Australia, much of the securities regulation in the US is designed to prompt full, accurate and timely disclosure of all material information. This disclosure to the market place is concerned with specific securities transactions including all aspects of market trading as well as capital raising and financial reporting by public companies.

Disclosure regulation in the US has evolved from the listing standards initially set by the New York Stock Exchange (NYSE). The exchange had no prescribed standards at its inception in 1792, but by

²⁷¹ London Stock Exchange listing rule 9.4, replaced by UKLA listing rule 9.4; *Admission and Disclosure Standards* May 2001, note 262 Part 2 at 3.4.

²⁷² London Stock Exchange *Model Code* to Chapter 16 of the Listing Rules (1999), replaced by Appendix to Chapter 16 of the UKLA *Listing Rules* 1 December 2001, note 263.

1866 it had acquired sufficient prestige to impose some requirements of financial disclosure on those companies wishing to list on the NYSE. Finally, in 1910, there was:

“...an effort to ensure that all corporations adhere to minimum disclosure requirements or lose the privilege of the floor”.²⁷³

Legislation in support of disclosure came later as a result of a market crisis:

“In the wake of the 1929 stock market crash and in response to widespread abuses in the Securities Industry, the 73rd Congress enacted two landmark pieces of securities legislation: the *Securities Act* 1933 and the *Securities Exchange Act* 1934. The 1933 Act regulated initial distributions of securities and the 1934 Act for the most part regulates post-distribution trading.”²⁷⁴

Taken together the Acts ‘embrace a fundamental purpose...to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*’.²⁷⁵ Section 10(b) of the *Securities Exchange Act* 1934 imposes civil liability on those who employ any manipulative or deceptive device or contrivance in connection with the purchase or sale of securities.²⁷⁶ This section focuses on the ‘use of a manipulative or deceptive device’ in connection with the trading process.²⁷⁷ Rule 10b-5, made under s10(b) and adopted by the SEC in 1942, provides in part that it is unlawful for any person, directly or indirectly, in connection with the purchase or sale of any securities, to employ any device to defraud, to make an untrue statement of a material fact or to omit to state a material fact necessary to clarify a statement.

Section 10(b) and rule 10b-5 appear to have more in common with other ‘Prohibited Conduct’²⁷⁸ provisions of the *Corporations Act* than with s1001A/674. For example, s995/1041H, which was modelled on s52 of the *Trade Practices Act* 1974 (Cth), was concerned with misleading and

²⁷³ Taylor CR ‘Capital Market Development in the Emerging Markets: Time to Teach an Old Dog Some New Tricks’ (1997) 45 *American Journal of Comparative Law* 71-107 at 80.

²⁷⁴ *Central Bank of Denver NA Petitioner v First Interstate Bank of Denver NA and Jack K Naber* 114 SCt 1439 (1994) Kennedy J.

²⁷⁵ *Affiliated Ute Citizens of Utah v United States* 406 US 128 (1972).

²⁷⁶ *Central Bank of Denver*, note 274 at 1443.

²⁷⁷ Baxt R, HAJ Ford and AJ Black *Securities Industry Law* Sydney Butterworths 5th ed 1996 at 316.

²⁷⁸ *Corporations Act* former Part 7.11 Division 2 – Prohibited Conduct replaced by Part 7.10 Division 2.

deceptive conduct in connection with any dealing in securities. This provision did not carry criminal penalties but s1005/1041I provided a remedy of civil damages for contraventions of s995/1041H and other breaches of the former Part 7.11 of the *Corporations Act*. Following the commencement of the *Financial Services Reform Act*, s1041I remedy is only available for contraventions of ss1041E-1041H.

The former s996,²⁷⁹ now s728 of the *Corporations Act* has similarities with s11 of the *Securities Act* 1933 (US), at least in relation to public offers of securities. Section 11 is concerned with any ‘untrue statement of material fact’ or omission of a ‘material fact required to be stated’ in dealing with registration statements.²⁸⁰ Failure to disclose material information in a prospectus was the subject of a decision of the US District Court in *Escott v BarChris Construction Co.*²⁸¹ The Court considered the underwriters, and others involved in a new issue of debentures, to be liable for the low standard of ‘due diligence’ in the preparation of the prospectus.

The focus of rule 10b-5 of the *Securities Exchange Act* 1934 is on a scheme to defraud in relation to securities trading. The rule shares this emphasis with the former market manipulation provisions of the *Corporations Act*, ss997-1001 as replaced by ss1041A-1041G, and the insider trading provision s1002G/1043A. Unlike s10(b) and rule10b-5 in the US, these former provisions of the *Corporations Act*, and including s728 and the continuous disclosure provision s1001A/674, are all subject to criminal liability under the general penalty provision, s1311. Many of these provisions are also subject to the expanded civil penalty regime by the amendments of *Financial Services Reform Act*, as discussed in Chapter 5.²⁸²

Michael Mann, a director of the SEC, points out that enforcement actions taken by the Commission in the US are generally characterised as ‘remedial’ rather than ‘punitive’.²⁸³ Mann states that there are two aspects of an effective regulatory regime to be considered. These are the rules to provide a legal

²⁷⁹ CLERPA, note 59, s728.

²⁸⁰ Baxt *et al* (1996), note 277 at 106.

²⁸¹ *Escott v BarChris Construction Co* 283 F Supp 643 (1968) (USDC) cited in G Golding ‘Underwriter’s Liability in Australian Securities Offerings’ (1993) 11 *Company and Securities Law Journal* 401-432 at 413.

²⁸² See section on *Civil Penalties* in Chapter 5.

²⁸³ Mann M ‘What Constitutes a Successful Securities Regulatory Regime?’ (1993) 3 *Australian Journal of Corporate Law* 154-177 at 184.

framework, accompanied by the enforcement procedures that implement that framework. The regulator summarises the rules into three axioms for listed companies, ‘do not lie, disclose fully and deal fairly’. In discussing the second point on full disclosure, Mann only nominates SEC rules on periodic annual and quarterly reports and special reporting requirements. There was no suggestion that additional SEC rules on continuous disclosure were thought to be necessary.²⁸⁴

There is uncertainty as to whether managers have:

“... an affirmative obligation to disclose information during the periods between the various quarterly and annual reports required by the SEC. However, legal scholars agree that there is no affirmative disclosure obligation unless there is a specific duty to disclose”.²⁸⁵

Such a duty would apply under the ‘disclose or abstain’ rule. This rule is directed towards those company officers with inside information. They must disclose all material information if they wish to trade in the securities of that company. However, the absence of US legislation that is specifically directed at a failure to disclose, or at insider trading, often forces the prosecution to prove fraud. In the *Chiarella*²⁸⁶ case, the Court considered whether s10(b) was violated when a person traded securities without disclosing inside information. It was held that the provision is not violated unless the trader had an ‘independent duty’ of disclosure. The Court noted that:

“...not every instance of financial unfairness constituted fraudulent activity under s10(b)²⁸⁷....s10(b) is aptly described as a catch all provision, but what it catches must be fraud. When an allegation of fraud is based on non-disclosure, there can be no fraud absent a duty to speak”.²⁸⁸

The decision of the US Supreme Court in *Chiarella* is seen to alter the interpretation of rule 10b-5. In *Chiarella* there was no positive duty to disclose material facts, as the defendant held no proprietary rights in the information.²⁸⁹ A concern for fairness guided an earlier decision in *SEC v Texas Gulf*

²⁸⁴ Ibid, at 180.

²⁸⁵ Skinner DJ ‘Why Firms Voluntarily Disclose Bad News’ (1994) 32 *Journal of Accounting Research* 38-60 at 40.

²⁸⁶ *United States v Chiarella* 445 US 222 (1980).

²⁸⁷ Ibid, at 232.

²⁸⁸ Ibid, at 234-235.

²⁸⁹ Whincop, note 30 at 215.

*Sulphur Co.*²⁹⁰ In this US insider trading case, the Court supported the principle of access to information for all investors as there is a:

“...justifiable expectation of the securities market place that all investors trading on impersonal exchanges have relatively equal access to information”.²⁹¹

The actions of company directors, trading on inside information, contradict this principle.

Standard periodic reporting requirements in the US include the submission of quarterly reports by companies. In Australia quarterly reporting is generally restricted to mining and investment companies.²⁹² A US reporting company must file a Form 10-Q quarterly report with the SEC within 45 days of the end of each of the first three quarters of the year. Information for the fourth quarter is included in a Form 10-K comprehensive annual report that is to be submitted within 90 days of the close of the financial year.²⁹³ As the time periods for the filing of these reports has been unchanged for 30 years, the SEC now proposes that public companies should file Form 10-Q quarterly reports within 30 days and the Form 10-K annual reports within 60 days.²⁹⁴ The SEC further mandated in 1980 that listed companies are to include a management discussion and analysis statement in the 10-K report. This additional disclosure is designed to supplement financial statements that are ‘insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance’.²⁹⁵

A Form 8-K notification, or current report, is used to advise the SEC of changes in the control of a company, the resignation of directors or other special notices.²⁹⁶ If the information does not fall

²⁹⁰ *SEC v Texas Gulf Sulphur Company* 401 F 2d 833 (1968), cert denied 394 US 976 (1969).

²⁹¹ Black AJ ‘The Reform of Insider Trading Law in Australia’ (1992) 15 *University of New South Wales Law Journal* 214-255 at 221.

²⁹² ASX listing rule 5.1-5.3 states that a mining company must complete a report and give it to ASX within one month after the end of each quarter of its financial year. Under listing rule 4.7B, certain companies must submit a quarterly cash flow report. See sections on *Periodic Disclosure* in Chapter 2.

²⁹³ Rosen RC ed *International Securities Regulation Binder 5* United States, April 1994 at 39.

²⁹⁴ US Securities and Exchange Commission ‘SEC to Propose New Corporate Disclosure Rules’ *Press Release* 2002-22 13 February 2002 1-5 at 2,3.

²⁹⁵ Regulation S-K Item 303, Securities Act Release No 6711 April 1987 52 FR 13715 cited in O’Keefe T ‘MD&A Quality as Measured by the SEC and Analysts’ Earning Forecasts’ University of Sydney Accounting Foundation *Research Seminar Series* 18 October 1996 at 1.

²⁹⁶ Rosen, note 293 at 40; CASAC (1991), note 2 at Annexure 2 at i.

within these specified categories then it is not necessary to file an 8-K notification, even if the information is ‘not generally available’ and could have a ‘material effect’ on the price of the securities. The SEC encourages but ‘does not require’ the disclosure of events not specified by Form 8-K.²⁹⁷

If a company is in possession of material price sensitive information, which is not subject to Form 8-K disclosure, then the information does not require public disclosure under SEC legislation until the next quarterly report is due. This situation often encourages selective disclosure. ‘Regulation Fair Disclosure’ (Regulation FD) was introduced on 10 August 2000 to curb ‘selective disclosure of material non-public information by issuers to analysts and institutional investors’.²⁹⁸ If the company chooses to disclose, it must not be done selectively but by publicly filing a Form 8-K with the SEC. Information can be disseminated ‘through another method’, which is usually the issuing of a press release as website publication alone does not satisfy Regulation FD’s broad distribution requirement.²⁹⁹ The company must also release the information on learning of any unintentional disclosure or breach of confidentiality. Regulation FD does not introduce a continuous disclosure regime but it does have a similar effect when the confidentiality of the information is breached, as disclosure is then required.

However, the SEC is moving closer to a continuous disclosure regime. The Chairman of the SEC now considers that a major initiative of the regulator is to improve current disclosure by:

“Supplementing Periodic disclosure with ‘current disclosure’. While there are modest attempts at requiring current disclosure in our present Form 8-K, these are limited and ambiguous. In the system we envision, public companies may be required affirmatively to disclose unquestionably material information when it arises and becomes available, even if the information is learned before the next-scheduled periodic report is due to be filed.”³⁰⁰

²⁹⁷ Skinner, note 285 at 41 n5.

²⁹⁸ US Securities and Exchange Commission ‘Regulation Fair Disclosure Revisited’ Special Study by Commissioner Laura S Unger December 2001 1-22 at 2; *ASIC Media Release* 00/365 23 August 2000.

²⁹⁹ *Ibid*, ‘Regulation Fair Disclosure Revisited’ at 4.

³⁰⁰ US Securities and Exchange Commission *Remarks at the PLI 33rd Annual Institute on Securities Regulation* Speech by SEC Chairman Harvey L Pitt New York 8 November 2001 1-5 at 4; also *Fall Meeting of the ABA’s Committee on Federal Regulation of Securities* Speech by SEC Chairman Harvey L Pitt Washington DC 16 November 2001 1-6 at 3.

Although a Form 8-K notification is an irregular reporting requirement, it has a narrower focus than the general disclosure rules of the NYSE, ASX and the *Corporations Act*. Under the ‘Timely Disclosure’ rule, the NYSE expects a company listed on its exchange:

“...to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange. A listed company should also act promptly to dispel unfounded rumours which result in unusual market activity or price variations.”³⁰¹

This rule closely echoes the continuous disclosure provision of the *Corporations Act* and ASX listing rule 3.1. In addition to the rules, the NYSE ‘listing agreement provides that a company must furnish the Exchange with such information concerning the company as the Exchange may reasonably require’.³⁰² The NYSE confirms that the ‘Timely Disclosure’ rule and SEC’s Regulation FD are similar, but the stock exchange still mandates the use of a press release, rather than ‘other methods’, as the most effective mechanism for promptly conveying information to the public.³⁰³

Canada

In Canada, a public listed company is a ‘reporting issuer’ under provincial securities regulations and the company is subject to ongoing disclosure requirements. Annual financial information, similar to a Form 10-K in the US, must be filed with provincial securities commissions. In 1989, the Ontario Securities Commission adopted management discussion and analysis requirements. These are normally included as part of the company’s annual report to shareholders. This management discussion report is intended to supplement disclosure and:

“...to give the investor the ability to look at the issuer through the eyes of management by providing both a historical and prospective analysis of the business of the issuer”.³⁰⁴

³⁰¹ New York Stock Exchange *Listed Company Manual* Rule 202.05 Timely Disclosure of Material News Developments (December 2001); C Davis *Continuous Disclosure: An Examination of the United States and Australian Approaches* School of Accounting University of NSW 1995; CASAC (1991), note 2 at Annexure 2 at ii.

³⁰² *Listed Company Manual* Rule 202.04 Exchange Market Surveillance (December 2001).

³⁰³ New York Stock Exchange *Regulation FD*: Letter to Listed Companies on the difference between the NYSE’s Timely Alert Policy and the SEC’s Regulation FD 22 March 2001.

³⁰⁴ Ontario Securities Commission Policy Statement No 5.10 November 1989 cited in P Clarkson ‘The Quality of Management Discussion and Analysis (MD&A): A Voluntary Disclosure Perspective’ University of Sydney Accounting Foundation *Research Seminar Series* 31 May 1995 at 4.

In addition, unaudited comparative quarterly statements for the first three, six and nine months of the financial year are to be filed with the Ontario Securities Commission and sent to shareholders within 60 days of the end of each quarter.³⁰⁵ A reporting issuer must also comply with the provision on continuous disclosure in Part XVIII of the Ontario legislation. Where a ‘material change’ occurs in the affairs of a reporting issuer, the company is required to issue ‘forthwith’ and file a news release. The announcement is authorised by a senior company officer and discloses the nature and substance of the material change.³⁰⁶

A more formal report detailing the change is to be filed as soon as practicable, and in any event within ten days of the date on which the change occurs.³⁰⁷ This form of continuous disclosure is a supplement to the periodic quarterly disclosure. It is designed to provide investors with equal and timely access to information that is likely to have a significant impact on the market price of a company’s securities.

There is a ‘carve-out’ to this disclosure obligation but it is far more limiting than the exemptions available under the ASX listing rules. If a reporting issuer in Ontario estimates that disclosure of a material change in the company’s affairs would be unduly detrimental to its interests, then the company can file a report with the Commission. The report is marked ‘confidential’ and is accompanied by the reasons why the company requests non-disclosure of the information. Every ten days the company must give further reasons for continuing non-disclosure, until such time as full disclosure is made.³⁰⁸

The Ontario *Securities Act*,³⁰⁹ rather than the stock exchange rules, provides the exemption for these confidential ‘sealed envelope’ disclosures. CASAC (1991) did not recommend this approach for Australia. It argued that greater certainty could be achieved by introducing specific categories of exemption as ‘carve-outs’ to ASX listing rule 3.1. In making this recommendation, CASAC

³⁰⁵ Ontario *Securities Act* s77(1) (December 2001); Lococo RA ‘Canada: Ongoing Disclosure’ (1997) June *International Legal Practitioner* 50-55 at 50.

³⁰⁶ Ontario *Securities Act* s75(1) (December 2001).

³⁰⁷ *Ibid*, s75(2).

³⁰⁸ *Ibid*, ss75(3), (4).

³⁰⁹ *Ibid*, Form 27 Policy Release 40 (1987).

considered the related administrative problems that could arise if such a system was implemented in the larger Australian securities market.³¹⁰

Although not specifically associated with disclosure, ASX listing rule 15.6 is included in the chapter concerning the requirements for documents submitted to the stock exchange. If the matter is confidential, the company should mark the document 'not for public release' prior to submitting it to ASX. The stock exchange will normally only publicly release the information in the document after warning the company that it is about to do so. There appears to be no standard procedure for the company to provide ongoing reasons for non-disclosure, such as the Ontario ten day rule discussed above.

It may be an offence if there is an omission or if a statement is 'misleading or untrue' in any of the reports filed with the Ontario Securities Commission. The penalty is a fine of not more than \$1,000,000 Canadian or two years in prison or both.³¹¹ The Commission has the right to apply to the Court for an appropriate order if a person or company is not complying with the law.³¹²

In March 1997, the Toronto Stock Exchange (TSE) issued a report by the Committee on Corporate Disclosure entitled *Responsible Corporate Disclosure*.³¹³ This report recommends amendments to the Ontario legislation, which would enable a person or company to take civil action for compensation against a reporting issuer that issues a document containing a misrepresentation. The right of action for damages would be available if the person acquired or disposed of securities of the issuer during the period between the time when the document was made available to the public, and the time when the misrepresentation was publicly corrected.³¹⁴ This right to civil action has many of the elements of the s1005/1041I remedy for misleading conduct under s995/1041H of the *Corporations Act*.

³¹⁰ CASAC (1991), note 2 Part D at 22 and Annexure 2 at iii.

³¹¹ Ontario *Securities Act* s122(1) (December 2001).

³¹² Ibid, s128(1).

³¹³ Toronto Stock Exchange *Responsible Corporate Disclosure: A Search for Balance* Committee on Corporate Disclosure Final Report March 1997.

³¹⁴ Ibid, at 63.

The findings of the Committee on Corporate Disclosure include a dissenting statement by committee member Phillip Anisman.³¹⁵ It outlines a number of relevant issues that are either not adequately covered in the Committee's report or are differing points of view. One example of the latter resembles the prohibited conduct provisions of the *Corporations Act*. Anisman suggests that if the legislation in Canada is amended to create civil liability for misstatements by issuers, then manipulative conduct by issuers should be addressed as well.³¹⁶

Rules of the various Canadian stock exchanges prescribe disclosure by listed companies of a broad range of 'material information'. In addition, the Canadian securities commissions have derived National Policy No 40 'Timely Disclosure' from the Toronto Stock Exchange's timely disclosure policy.³¹⁷

The TSE's timely disclosure policy is similar in content and intent to *ASX Listing Rules* Guidance Note 8 on Continuous Disclosure. Listed companies must comply with these rules in addition to the provisions on timely disclosure set out in s75 of the Ontario *Securities Act* and its regulations. TSE has complemented the timely disclosure policy with the *Electronic Communications Disclosure Guidelines*³¹⁸ to outline standards of best practice in electronic communications with investors.

³¹⁵ Philip Anisman was commissioned to report on insider trading in Australia for the Griffiths Committee.

³¹⁶ *Responsible Corporate Disclosure*, note 313 at 111.

³¹⁷ Toronto Stock Exchange *Policy Statement on Timely Disclosure* (undated) 1-16 at 2.

³¹⁸ Toronto Stock Exchange *Electronic Communications Disclosure Guidelines* Final Guidelines 25 March 1999.

CHAPTER 5

Legal Context of Continuous Disclosure

'Conduct in Relation to Securities'

The continuous disclosure provision was introduced two months later than, but as a part of, the original ED regime. However, it was not inserted into the legislation with the other ED provisions. Instead, the provision more appropriately became part of 'Prohibited Conduct' in Division 2 of Part 7.11 of the *Corporations Act* concerning 'Conduct in Relation to Securities'. This original positioning highlighted the overlap between the continuous disclosure provision and the earlier s995/1041H prohibitions in Division 2 on misleading and deceptive conduct, and particularly s1002G/1043A in Division 2A on insider trading. These provisions are discussed in the following sections.

This nexus between continuous disclosure and the other prohibited conduct provisions is altered by the commencement of the *Financial Services Reform Act*. The continuous disclosure provision s674, which largely replicates s1001A, is located in a new Chapter 6CA of the *Corporations Act* that is specifically devoted to continuous disclosure. This placement, prior to Chapter 6D on fundraising disclosure, is designed to reflect 'the fact that these provisions deal with ongoing obligations in relation to securities'.³¹⁹

Although one aim of the *Financial Services Reform Act* is to extend ongoing disclosure obligations to financial products other than ED securities, these are not included in Chapter 6CA. As discussed later in the section on *Civil Penalties*, another aim of the amendments is to extend the civil penalty regime to a number of the Divisions 2 and 2A provisions of the former Part 7.11. The prohibitions in the replacement Divisions 2 and 3 of Part 7.10 are again directed towards a 'person'. Since the introduction of the *Corporations Act*, s22(1)(a) of the *Acts Interpretation Act* 1901 (Cth) replaces s85A of the *Corporations Law* in defining a 'person' to implicate a body corporate as well as an individual in these prohibitions.

³¹⁹ *Explanatory Memorandum*, note 11 at 18.1.

'Misleading or Deceptive' and Other 'Prohibited Conduct'

A general prohibition on misleading and deceptive conduct in relation to a 'financial product or a financial service' is introduced by s1041H to replace s995, as the latter provision applies only in connection with 'any dealing in securities'. Any contravention of the new provision will continue to attract civil liability only under s1041I, replacing s1005, and will not be included in the civil penalty regime.³²⁰

Section 995(2)/1041H(1), (2) prohibits misleading or deceptive conduct by a person in connection with any dealing in securities. This includes the allotment or issue of securities, an evaluation or recommendation in relation to a takeover bid, and any notice published or negotiation undertaken in relation to securities (s995(2)(b)/1041H(2)(b)).³²¹ The definition of a 'person' could extend liability to a body corporate that makes a misleading statement under its continuous disclosure obligation. It could also be exposed to civil liability for a resulting loss if the disclosure is likely to mislead or deceive.

Although s995/1041H was modelled on s52 of the *Trade Practices Act*, s51AF(2) subsequently excluded s52 from 'conduct engaged in relation to a financial service'. Section 51AF(2) was introduced by the *Financial Sector Reform (Consequential Amendments) Act* 1998, effective 1 July 1998. A 'financial service' is defined as a service that is supplied, including the offering of a disclosure document, in relation to a financial product such as securities.³²² The implication of this amendment is that an action for a misleading and deceptive statement concerning securities would now be taken under s995/1041H of the *Corporations Act* rather than s52 of the *Trade Practices Act*.³²³

The *Corporate Law Economic Reform Program Act* 1999 (CLERPA) was passed by Federal Parliament in October 1999 and new legislation commenced on 13 March 2000.³²⁴ As the misleading

³²⁰ Ibid, at 15.8, 15.9.

³²¹ CLERPA, note 59, inserted s995(2A) to include an exception for conduct that contravenes s670A (misleading or deceptive takeover document) and s728 (misleading or deceptive fundraising document). This exception continues post *Financial Services Reform Act* in s1041H(3) (see *Explanatory Memorandum*, note 11 at 15.10).

³²² ASIC Act s12BA.

³²³ Ford HAJ, RP Austin, IM Ramsay *Ford's Principles of Corporations Law* Sydney Butterworths 10th ed 2001 at 930.

³²⁴ CCH Australia Limited *Australian Corporate News* 20 October 1999.

and deceptive conduct provisions of the *Trade Practices Act* and the fair trading legislation of the states³²⁵ no longer apply, liability in connection with securities is self-contained within the *Corporations Act*. The overlap between the two provisions, ss995/1041H and former 996, has been eliminated. For example, an action similar to *Fraser v NRMA Holdings Limited*³²⁶ would now rely on s728, which was created for misleading and deceptive statements in a disclosure document or prospectus.³²⁷

Section 995/1041H was supplemented by the former s765, which corresponded to s51A of the *Trade Practices Act*. This provision extended the scope of s995/1041H of the *Corporations Act* to a misleading representation with respect to any future matter. Prior to the introduction of CLERPA, the normal onus of proof on the plaintiff, to prove that there were no reasonable grounds for making a misleading statement, was reversed. The onus of proof was on the person who made the representation. That person was required to show that there were reasonable grounds for the statement. If this proof was inadequate, then the person would be deemed not to have had reasonable grounds under the former s765(2). This reversal of onus has now been repealed.³²⁸

According to former s765(1), a misleading representation could result from a person refusing to do an act. This could include refusal to make full disclosure concerning a future matter if the company's directors considered the information to be within the exemptions of ASX listing rule 3.1. A future matter could be exempt as a 'carve-out', and so also exempt under s1001A/674. Prior to CLERPA, if the omission was considered misleading, then the company might have had the burden of disproving the s765(1) presumption. If the directors of a company did not have reasonable grounds for an omission, or less than full disclosure concerning a future matter, then the action was likely to be misleading.

The former s765 is now found within the scope of s728, the former s996, and refers to a misleading statement concerning a future matter in a fundraising disclosure document (s728(2)). The implication

³²⁵ CLERPA, note 59, former s995A.

³²⁶ *Fraser and Anor v NRMA Holdings Limited and Others* (1995) 127 ALR 543; 15 ACSR 768.

³²⁷ Minter Ellison *Corporate Law Update* October 1999; CLERPA, note 59, s728 rather than the former s996 or s995/1041H of the *Corporations Act*, or s52 of the *Trade Practices Act*.

³²⁸ CLERPA, note 59, repealed s765(2).

of the earlier reverse onus of proof was greater in this instance, as a breach of the former s996 was an offence that might incur Schedule 3³²⁹ penalties.

ASX was concerned that this reversal of the burden of proof in the former s765(2) was discouraging capital raising by small and medium sized companies. There was considerable expense involved in a detailed due diligence procedure to prove that there was a reasonable basis for a statement concerning a future matter. ASX suggested that a 'statement of risks' would better serve investors and fundraisers as the basis for a defence. If directors:

“...identify the omissions, state risks and disclose material facts in relation to such risks, they should not be liable for omissions”.³³⁰

The reverse onus of proof in s765(2) was removed in March 2000 to encourage these forward looking statements and forecasts.³³¹

There could have been further implications if a company was a disclosing entity and issued a special prospectus under s713.³³² Prior to CLERPA, in return for compliance with the ED regime, a company could issue a limited prospectus in relation to a class of securities that had been listed on the stock exchange for at least 12 months. For this purpose, the former s1022AA³³³ was inserted into the legislation in September 1994 and this provision subsequently formed a foundation for the new s713, which was substituted by CLERPA in March 2000. The format of a special prospectus under s713 is more concise as most earlier documents and disclosures released by the company do not have to be included if they have already been lodged with ASIC.

Statements issued under the continuous disclosure provision could have been vulnerable, if they had included an intention or a prediction of a future matter, which due to an omission was misleading under s728, formerly s996. This situation could occur if a company relied on a 'carve-out' to avoid disclosure. However, the legislation anticipates this problem and s713(5)(a), formerly s1022AA(6), overrides the confidentiality and 'carve-out' exemptions of ASX listing rule 3.1. The result is that

³²⁹ Schedule 3 Penalties, note 19.

³³⁰ Roche M 'Why ASX Argues for Prospectus Reform' (1997) 2nd Quarter *ASX Perspective* 60-62 at 61.

³³¹ Securities Institute *Securities Industry Law and Ethics* Second Semester 1999 (lecture notes) at 5-21; Butterworths *Corporate Law Economic Reform Bill 1998* (March 1999) s728(2).

³³² Baxt *et al* (1996), note 277 at 59.

³³³ CLERPA, note 59, s713.

information, previously undisclosed in reliance on a ‘carve-out’, must be included in the prospectus of an offer for continuously quoted securities.

Although s995, and replacement s1041H, only attract civil liability, an officer of the corporation may commit an offence by providing information in which a material particular or omission is false or misleading. If such information relates to the affairs of the corporation and is knowingly made available to a securities exchange, director, auditor, member, debenture holder or trustee, then the officer commits an offence under s1309(1).³³⁴ The lesser fault element applies to s1309(2)³³⁵ if an officer of the corporations fails to take reasonable steps to ensure the accuracy of the information. CASAC (1996) also acknowledged that potential criminal liability existed under s1308(2) and former s999 for a person providing false or misleading statements to the market.³³⁶

The *Financial Services Reform Act* replaces ss999 and 1261, thereby prohibiting the making of statements and dissemination of information that may induce others to act with regard to both securities and futures contracts. These provisions are replaced by s1041E, which applies to all financial products.³³⁷ Similarly, s1041F(1) replaces ss1000(1) and 1262 and extends the prohibition to inducing ‘another person to deal in financial products’. The provision may apply if the person knows or is reckless as to whether a published statement or ‘dishonest’ concealment of material facts is misleading, false or deceptive. Section 1041F(2) incorporates a definition of conduct that is ‘dishonest’ according to the standards of ordinary people and known by the person to be dishonest by such standards. Identical terminology is used in a newly inserted s1041G(2) concerning dishonest conduct in the course of carrying on a financial services business.³³⁸

However, unlike the continuous disclosure and insider trading provisions, ss1041E to 1041H are not civil penalty provisions and any contravention may lead to civil liability under s1041I. Failure to comply with the prohibited conduct provisions, ss1041E to 1041G, continues to be an offence under Schedule 3.

³³⁴ Schedule 3 Penalties: 100 penalty units or imprisonment for two years or both. A penalty unit is \$110 (s4AA of the *Crimes Act 2001* (Cth)).

³³⁵ 50 penalty units or imprisonment for one year or both.

³³⁶ CASAC (1996), note 26 at 16.

³³⁷ *Explanatory Memorandum*, note 11 at 15.17.

³³⁸ *Ibid*, at 15.19; Longo, note 32 at 29.

Insider Trading

As discussed in Chapter 1, the drafting similarities between the insider trading and the continuous disclosure provisions are not coincidental. The two provisions reveal both sides of the one issue; non-disclosure can result in insider trading, while full and timely disclosure is designed to eliminate insider trading. The nexus between these two provisions is less apparent since the amendments of the *Financial Services Reform Act*, with continuous disclosure at s674 and insider trading at s1043A.

Regulation of insider trading was extensively reviewed and reformed as part of an effort to curtail the perceived excesses of the pre-1987 era.³³⁹ Regulators have prohibited insider trading in Australia since the introduction of s75A of the *Securities Industry Act 1970* (NSW), which carried both civil and criminal liability.³⁴⁰ Prior to amendments introduced by the *Corporations Legislation Amendment Act 1991*, effective 1 August 1991, the prohibition on insider trading applied only to a person who, under the former s1002(1), was ‘connected with’ a body corporate at any time in the six months preceding the transaction. The provision considered officers or substantial shareholders of the company, or a related company, to be connected with the company. It also included persons who had a business or professional relationship with the company (s1002(9)).

The 1991 amendment transferred the emphasis from consideration of the insider’s connection with the company, to the information possessed by the insider and, more particularly, to the use made of that information. It is no longer necessary to demonstrate a fiduciary link or a duty of care between the insider and the company. The initial prosecution by ASIC of Simon Hannes, discussed in the section on *Insider Trading Case Law*, might not have been possible under the former s1002(1). As Hannes was not an officer of the company whose securities were traded, and was not involved as an adviser to the company, it would have been difficult to establish that he owed a fiduciary duty or a duty of care to the company.

Section 1002G/1043A prohibits a person from buying, selling or subscribing for shares if that person possesses information that is likely to have a material effect on the price of a company’s securities

³³⁹ CASAC (1996), note 26 Appendix 6 Executive Summary at 1.

³⁴⁰ Baxt *et al* (1996), note 277 at 310: Insider trading was prohibited by s75A of the *Securities Industry Act 1970* (NSW) and the prohibition was extended by s112 of the *Securities Industry Act 1975* (NSW). The provision became s128 of the *Securities Industries Act 1980* and part of the *Companies Code 1989*. In turn it became s1002 of the *Corporations Law 1990* and s1002G following the *Corporations Legislation Amendment Act 1991*. From 11 March 2002 it is s1043A of the *Corporations Act 2001*.

but is not generally available (ss1002G(1)/1043A(1), 1002G(2)(a)/1043A(1)(c)). An insider is also prohibited from procuring another person to buy, sell or subscribe for the securities (s1002G(2)(b)/1043A(1)(d)).

If the securities are listed on the stock exchange then an anti-tipping provision applies. An insider is prohibited from communicating the information to other persons who would be likely to trade or subscribe for the securities on the basis of the information (s1002G(3)/1043A(2)(c))

In the conviction, now quashed, of Kenneth John Firms, for trading on insider information concerning Carpenter Pacific Resources NL, the information was considered not generally available. In this case the information was communicated by telephone to Firms, who then traded the securities on the basis of the information. Further discussion of this case is included in the following section on *Insider Trading Case Law*.

Legislative changes to the insider trading provision were introduced largely as a result of the recommendations of the Griffiths Report³⁴¹ in 1989 and the earlier Anisman³⁴² study of insider trading in Australia. Both these documents recognised the issue as ‘essentially a problem of non-disclosure’.³⁴³ Non-disclosure accentuates the difference between the value of the securities, as the insider knows it, and the value placed on these securities by the market place.

The limited convictions under the expanded insider test, discussed in the following section, indicate that the reforms to s1002G/1043A have not greatly changed the situation and attest to the difficulty of establishing a criminal standard of proof for insider trading. This same difficulty of interpretation would be encountered in any action taken under s1001A/674. For this reason, the extension of the civil penalty regime to the new provisions, s674 and s1043A, following commencement of the *Financial Services Reform Act* will assist the regulators.³⁴⁴

³⁴¹ Parliament of the Commonwealth of Australia *Fair Shares for All: Insider Trading in Australia* Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs Canberra AGPS October 1989 (Griffiths Report).

³⁴² Anisman P *Insider Trading Legislation for Australia: An Outline of the Issues and Alternatives* Canberra AGPS 1986.

³⁴³ *Ibid*, at 2.

³⁴⁴ See later section on *Civil Penalties*.

Further criticism of insider trading and the *laissez faire* environment of the 1980s emanates from academic circles, namely the papers by Tomasic and Pentony.³⁴⁵ They contend that the securities industry and the regulatory bodies have failed to be sufficiently rigorous in prosecuting lapses in corporate disclosure that are likely to result in insider trading. These organisations have been:

“...poorly resourced and inadequately staffed and equipped to deal with complex crimes such as insider trading”.³⁴⁶

The two academics conducted a survey of the opinions of industry participants. They concluded from the responses that securities law had reached its limit in being able to control the social and economic problems of insider trading. The Tomasic and Pentony study has been the subject of criticism, mainly related to the methodology of the survey. The study was based on an ‘open ended interview schedule’ with regulators, lawyers, brokers and advisers from the securities industry.³⁴⁷

This investigative method was criticised for providing empirical evidence of the opinions of those who were interviewed, but not providing sufficient factual evidence. Ashley Black³⁴⁸ compared this method to conducting contemporaneous interviews of the clergy and lawyers of Salem in order to establish the extent of witchcraft. In neither instance did the opinions necessarily represent the facts.

Another critic has suggested that quantitative research would have been more appropriate to an appreciation of the extent of insider trading. Dempsey³⁴⁹ used, as a basis of her research, a study by Jaffe³⁵⁰ of the *Official Summary of Insider Trading* published by the US Securities and Exchange Commission. However, Jaffe categorised corporate officers, directors and large stockholders as insiders. This definition, although appropriate in most instances, is closer to that of an insider under the old version of s1002. A broader current definition is of any person who possesses information

³⁴⁵ Tomasic R (with the collaboration of B Pentony) *Casino Capitalism? Insider Trading in Australia* Australian Institute of Criminology 1991 at 126.

³⁴⁶ Ibid.

³⁴⁷ Tomasic R ‘A Comment on Socio-legal Research and Insider Trading in Australia’ (1996) 29 *Australian and New Zealand Journal of Criminology* 276-281.

³⁴⁸ Black, note 291 at 218.

³⁴⁹ Dempsey G ‘Socio-legal Research and Insider Trading in Australia’ (1996) 29 *Australia and New Zealand Journal of Criminology* 265-275.

³⁵⁰ Jaffe JF ‘Special Information and Insider Trading’ (1974) 47 *The Journal of Business* 410-428 reprinted in Castagna and Skully, note 149 at 251.

that is not generally available and that a reasonable person would expect to have a material effect on the price of a company's securities (s1002G(1)/1042A).

It is also suggested that research into the microstructure of the market place would be a more appropriate method of detecting insider trading. If there is a wide bid-ask spread, or difference between the price at which an investor is prepared to buy securities and the price demanded by the seller, then it implies uncertainties in trading. This wide bid-ask spread indicates that other traders might be in possession of superior, possibly undisclosed, information. Buyers will be reluctant to raise their bids in this climate of uncertainty and the wider bid-ask spread could be considered insurance against trading with suspected insiders.³⁵¹

As discussed in the section on *Mandatory Disclosure* in Chapter 2, the consequences of insider trading and a lack of disclosure could be a decline in investor confidence. Participants are likely to vacate the market if there is a perceived bias towards those traders with insider knowledge.³⁵²

Tomasic and Pentony infer that insider trading is most likely to occur in the securities of companies with lower capitalisation and that the insiders, most probably, are officers of the company. Brown and Foo test this opinion in a study on the 1996 profitability of directors' sales and purchases in the securities of their companies. Results of the study indicate that a director's sales are profitable, in that this action avoids a future loss situation, but the purchases are not profitable.³⁵³ This study provides some support for Tomasic and Pentony's argument, as directors of smaller companies seem to be the most likely to trade in the securities of their own company. However, there is little evidence that a director's trading profitability is directly related to either the size of the company or the size of the director's trade.³⁵⁴

Freeman and Adams³⁵⁵ base their study on questionnaires sent to directors and senior officers of listed companies in late 1995. The responses indicate that a large proportion of corporate insiders

³⁵¹ Copeland T and D Galai 'Information Effects on the Bid-Ask Spread' (1983) 38 *Journal of Finance* 1457-1469 in Dempsey, note 349 at 272-273.

³⁵² Akerlof, note 138.

³⁵³ Brown and Foo, note 198 at 1.

³⁵⁴ *Ibid*, at 7, 12.

³⁵⁵ Freeman MA and MA Adams 'Australian Insiders' View on Insider Trading' (1999) 10 *Australian Journal of Corporate Law* 148-161.

could be relying on inside information for the timing of their trading decisions. In spite of this, most of the respondents support the criminal liability attached to insider trading and consider current enforcement of the provision to be inadequate. The authors conclude from this conflicting attitude that corporate insiders view the current insider trading regulation as ineffective and they would possibly take advantage of this weakness. An alternate interpretation is that ‘directors did not regard what they were doing as insider trading’.³⁵⁶

These studies were possible because of amendments to the former s235³⁵⁷ of the *Corporations Act*, introduced in December 1995. Prior to this amendment, directors were only obliged to maintain a register of their interests and to notify the company of any changes in relevant holdings. Since CLERPA, s235 has been replaced by s205G, which carries the same demand that directors notify ASX of any change to their relevant interests in the securities of their company.³⁵⁸ Criminal liability exists under s1311 and Schedule 3³⁵⁹ for a contravention of s205G.

Directors’ knowledge of their company is of great strategic advantage when initiating a trade and this is only partially alleviated by post-trade disclosure of their position. It is argued that this contributes to a strong case for a prohibition on the officers of a company to prevent them from trading on information that they acquire in their corporate capacity. Such trading can increase the transaction costs to uninformed traders.³⁶⁰

Recommendations ‘to remove the shortcomings in the current 205G requirement’³⁶¹ for directors’ disclosure was one outcome of a CASAC³⁶² discussion paper on insider trading, released in June 2001. CASAC suggests that the disclosure requirement should be extended beyond directors to

³⁵⁶ Ibid, at 157.

³⁵⁷ CLERPA, note 59, s205G.

³⁵⁸ Ibid, s205G(1),(3) and (4) Notification must be within 14 days after each occasion.

³⁵⁹ Schedule 3 Penalties: 10 penalty units or imprisonment for three months or both. A penalty unit is \$110 (s4AA of the *Crimes Act 2001* (Cth)).

³⁶⁰ Whincop, note 30 at 231.

³⁶¹ Australian Securities and Investments Commission ‘Insider Trading: CASAC Discussion Paper’ *CASAC Papers* 16 July 2001.

³⁶² Companies and Securities Advisory Committee (CASAC) *Insider Trading Discussion Paper* June 2001 Chapter 4 at 97.

include all senior executive officers and that disclosure should be required within the shorter period of five business days, instead of the existing 14 days.

ASX has already moved to introduce listing rules 3.19A and 3.19B with a director's disclosure obligation from 1 January 2002.³⁶³ These rules require an entity to notify the market within five days³⁶⁴ of a director's holdings in the entity and any subsequent change to this interest.³⁶⁵ The company has the obligation to enforce these arrangements with the director. Where a company complies with listing rule 3.19A, the obligations of the relevant director under s205G will be considered satisfied.³⁶⁶

Another ASX proposal, that now complements the above amendment, is the addition of Item 10 of ASX's indicative list of corporate governance matters. A company can take into account when making a statement to be included in its annual report under listing rule 4.10.3:

‘The entity’s policy on the trading of its securities by directors and employees, including the uses of trading windows.’³⁶⁷

Insider Trading Case Law

The 1996 case, *Ampolex Limited v Perpetual Trustee Company (Canberra) Limited*,³⁶⁸ offers an interesting commentary on s1002B(2)/1042C and the similarly worded s1001C(2)/676(2). The plaintiff alleged that the defendants possessed knowledge that one of their number intended to convert Ampolex notes to ordinary shares at a ratio of 6.6 to one. As most investors understood the conversion rate to be one note to one share, this was considered ‘information not generally available’ within the wording of both the above sections? In answer to the three primary questions posed by the

³⁶³ *ASX Listing Rules Amendments* at 30 September 2001.

³⁶⁴ *Insider Trading Discussion Paper*, note 362 at 4.5; Australian Stock Exchange Limited ‘Proposed Listing Rule Amendments’ *ASX Exposure Draft* 23 January 2001 at 2: ASX had originally wanted notification within two days but this was considered too short a period by a large number of respondents to the proposal.

³⁶⁵ Listing rule 3.19A.1 (Appendix 3X) and listing rule 3.19A.2 (Appendix 3Y).

³⁶⁶ *ASX Listing Rules Guidance Note 22 Director Disclosure of Interests and Transactions in Securities – Obligations of Listed Entities* pars 6, 9 and 17 issued September 2001.

³⁶⁷ *ASX Exposure Draft* 23 January 2001, note 364 at 2; *ASX Listing Rules Guidance Note 9 Corporate Governance* at 40 and Attachment – List of Corporate Governance Matters Item 10. Also see discussion on *ASX Trading and Disclosure Policy* in Chapter 6.

³⁶⁸ *Ampolex Limited v Perpetual Trustee Company (Canberra) Limited* (1996) 20 ACSR 649.

provisions, Rolfe J of the Supreme Court of NSW, Commercial Division, held the *prima facie* view that:

- there was ‘information’,
- it was not ‘generally available’, and
- if the information had been generally available a reasonable person would expect it to have the specified material effect on the market price of the securities.³⁶⁹

Rolfe J stated that it was unfortunate that the tests in the provisions were couched in language that was difficult to understand and apply. This could result in a consequence contrary to the intended beneficial effect of the legislation. He was critical of the drafting of these tests of former s1002G:

“I should say that much of the argument has arisen from the drafting of this part of the law. The problems of construction and interpretation which it presents were readily acknowledged by all counsel and it is a matter of concern that legislative provisions which create serious criminal offences *inter alia*, should provide not only difficulties of interpretation because of the language used, but because of apparent internal inconsistencies.”³⁷⁰

Until 1999, there had been only three convictions³⁷¹ for insider trading since the scope of the provision was widened by the 1991 amendments. Of these three convictions, the last, in June 1998, was of a former Perth stockbroker, Russel Cribb, who pleaded guilty to charges of share trading while in possession of undisclosed price sensitive information. He had advised associates to purchase shares in a particular company while knowing that there was an offshore buyer willing to purchase the securities at a higher price.³⁷² This was the first successful conviction outside New South Wales. The two prior convictions concerned a Sydney public relations consultant in October 1996³⁷³ and, in

³⁶⁹ Ibid, at 659.

³⁷⁰ Ibid, at 658.

³⁷¹ Semaan *et al*, note 259 at 246.

³⁷² Australian Securities and Investments Commission *ASIC Annual Report 1998-99* at 3; Russel Cribb was fined \$20,000 and received a banning order following a guilty plea to ten counts of insider trading. Cribb had purchased shares in Cortecs International Limited on the Australian market, while knowing that there was a UK order that could be filled at a higher price. *ASIC Media Release 98/104* in Gething M ‘Insider Trading Enforcement: Where are we and where do we go from here?’ (1998) 16 *Company and Securities Law Journal* 607-627 at 615; *ASIC Media Release 98/240* 13 August 1998.

³⁷³ In January 1996, ASIC charged Murray Williams, a public relations consultant to Australis Media Limited, with insider trading. Following a plea of guilty he was fined \$50,000 and sentenced to 18 months periodic detention. *ASIC Media Releases 96/10, 96/139 and 96/219* cited in Gething, note 372 at 614.

December 1997, a former managing director of the European division of a listed company. All three convictions resulted in fines, in addition to periodic detention for the 1996 conviction.³⁷⁴

The more recent jury conviction of Simon Hannes on 11 August 1999 was strongly defended and the initial success by the prosecution was largely due to a detailed investigation by ASIC. Judge Backhouse, in the Sydney District Court, sentenced Hannes to two years and two months prison for insider trading in TNT call options.³⁷⁵ He was also fined \$100,000 and a further \$10,000 for bank withdrawals that contravened the *Financial Transactions Reports Act* 1988 (Cth). The \$2 million profit that resulted from the transaction by Hannes was frozen by ASIC and finally returned to the parties on the other side of these transactions.³⁷⁶

The NSW Court of Criminal Appeal subsequently quashed the conviction of Hannes and a new trial was ordered.³⁷⁷ This decision was swiftly followed by ASIC's announcement in December 2000 that the Commonwealth Director of Public Prosecutions sought a retrial of Hannes on the insider trading and other charges.³⁷⁸ This retrial commenced in October 2001 in the Supreme Court of NSW.³⁷⁹

In November 1999, a case of possible insider trading in the securities of Mt Kersey Mining NL came before the Victorian Supreme Court.³⁸⁰ This case had the potential to clarify a number of ambiguities in the legislation. At issue, was the timing and manner of dissemination of information before it could be considered 'generally available' under s1002B(2)/1042C and, indirectly, under the similarly drafted disclosure provision s1001C(2)/676(2). The other major issue was that there was no relationship, other than adjoining leases held by the two companies, between undisclosed information

³⁷⁴ Brook S 'Stockbroker Faces Jail Over Cortecs Insider Trading' *The Australian* (22 April 1998) 23.

³⁷⁵ *ASIC Media Release* 99/278 11 August 1999; *ASIC Media Release* 00/513 1 December 2000. *ASIC Annual Report 1999-2000* at 30: Hannes successfully appealed, the decision was quashed and a new trial was ordered.

³⁷⁶ *ASIC Media Statement* 99/329 17 September 1999.

³⁷⁷ *ASIC Media Release* 00/513 1 December 2000. In *R v Hannes* (2000) 36 ACSR 72 at 392, Spigelman CJ, Studdert and Dowd JJ held that '...the strength of the Crown case and the public interest involved in the prosecution of this offence was such that the proper order to make is for a new trial'.

³⁷⁸ *ASIC Media Release* 00/544 19 December 2000.

³⁷⁹ Mychasuk E 'Insider Trading Trial Faces Lengthy Delay' *The Sydney Morning Herald* (29 October 2001) 33.

³⁸⁰ *R v Evans and Doyle*, note 211.

concerning an unlisted company, Mining Project Investors Pty Ltd, and trading in the listed securities of Mt Kersey Mining NL. The two defendants were committed for trial in August 1998 following an ASIC investigation.³⁸¹ One defendant was a director of the unlisted company and the other a former trader with a Melbourne stockbroking firm.

Regrettably, from the point of view of continuous disclosure, the Mt Kersey case failed to clarify any of the anticipated issues.³⁸² After much legal argument concerning an appropriate definition of ‘an agreement to purchase shares’ under s1002G(2)/1043A(1)(c), McDonald J directed the jury to return a verdict of not guilty as ‘ASIC and the Commonwealth Department of Public Prosecutions had incorrectly presented their case’.³⁸³

It is recognized that a principal and agent agreement, resulting in a fiduciary and contractual relationship, exists between the two parties from the time a client places an order with a broker. This is evidenced by the motto of the London Stock Exchange, and also the former Stock Exchange of Melbourne, ‘My Word is My Bond’.³⁸⁴ However, the decision of McDonald J indicates that this interpretation does not apply to ‘an agreement’ under s1002G(2)/1043A(1)(c), until the trade is executed through SEATS.

CASAC recognizes that an insider may incur liability, either from the time the client instructs the broker, from when the bid or offer is placed on SEATS or, as stated in the Mt Kersey case, from the time the trade is executed on SEATS.³⁸⁵ The Advisory Committee proposes legislative amendments to decide this point, and also to clarify the liability of a broker who knowingly executes transactions in the relevant securities on behalf of an insider.³⁸⁶

³⁸¹ ASIC Media Release 98/256 28 August 1998.

³⁸² *Australian Corporate News* 1999, note 324 at 411.

³⁸³ ASIC Media Statement 99/447 16 November 1999; Reece N ‘Judge Throws Out Insider Trading Case’ *The Australian Financial Review* (17 November 1999) 1, 6.

³⁸⁴ “In 1965 the Stock Exchange of Melbourne was granted its own coat of arms...[the] motto ‘My Word is my Bond’ is a reminder of the motto of The Stock Exchange, London, *Dictum Meum Pactum*, and was adopted with their kind permission.” Adamson G *A Century of Change: the First Hundred Years of the Stock Exchange of Melbourne* Melbourne Currey O’Neil Ross Pty Ltd 1984 at frontispiece.

³⁸⁵ *Insider Trading Discussion Paper* June 2001, note 362 at 2.180; ‘Insider Trading: CASAC Discussion Paper’ 16 July 2001, note 361.

³⁸⁶ *Insider Trading Discussion Paper* June 2001, note 362 at 2.188.

Two other recent insider trading cases have further added to the ambiguity of when information is considered ‘generally available’ as a result of it being a ‘readily observable matter’ under either s1002B(2)(a)/1042C(1)(a) or s1001C(2)/676(2). Both cases arise from ASIC investigations into trading in the securities of Carpenter Pacific Resources NL on 28 July 1995. These transactions occurred immediately following a ruling in the Papua New Guinea (PNG) Supreme Court of Waigani, which would greatly improve the prospects of Carpenter’s gold mining rights.³⁸⁷

The first decision resulted in an initial conviction in November 1999, when the jury in the Downing Street District Court found Kenneth John Firms³⁸⁸ guilty of insider trading. The defendant was not present in the PNG Court when the Carpenter ruling was handed down but he had purchased the shares soon after receiving a telephone call from his father who was in Sydney. Firms senior had been alerted to the decision by a call from the chairman of the Carpenter’s who also received the news by telephone.³⁸⁹ Judge Sides, in the Downing Street decision, told the jury in summing up that the Crown had to establish beyond a reasonable doubt:

“...that the material or information was not easily noticed or perceived by any of our senses by someone who was within Australia”.³⁹⁰

By these guidelines, the PNG decision concerning the mining rights was not a ‘readily observable matter’ as regards s1002B(2)(a)/1042C(1)(a).

The second decision occurred on 2 December 1999,³⁹¹ when Judge O’Reilly in the Liverpool District Court ordered the jury to acquit James Kruse, a former employee of Carpenter Pacific’s PNG subsidiary, after the defence lodged a ‘no case to answer’ application. In this instance, the defendant was present in the PNG Supreme Court at the time the Carpenter decision was handed down in open

³⁸⁷ *ASIC Media Release 98/348* 17 November 1998.

³⁸⁸ In the Campbelltown District Court, Firms was sentenced to 14 months in prison after being found guilty of two charges by ASIC of insider trading and procuring another person to trade in securities. The pecuniary penalties amounted to the proceeds of the profit from the share trading. Firms was the son of a former director of Carpenter Pacific Resources NL. *ASIC Media Release 00/168* 14 April 2000; 98/244 17 August 1998; *Australian Corporate News* 1999, note 324 at 411.

³⁸⁹ *R v Firms* (2001) 38 ACSR 223, Mason P at 19.

³⁹⁰ *Ibid*, at 34.

³⁹¹ *R v Kruse* District Court of New South Wales 2 December 1999 cited in *R v Firms*, note 389 at 32.

court. Judge Reilly held that the decision in the PNG Supreme Court was in the ‘public arena’ and therefore constituted ‘readily observable matter’.³⁹²

Mason P, in the successful appeal by Firms in May 2001 against his conviction, admitted that here were two inconsistent verdicts and that ‘the acquittal of Kruse and the conviction of the appellant cannot be reconciled on the facts’.³⁹³ This division of opinion was also apparent in the Firms appeal case, as Carruthers AJ in a dissenting judgment could not accept that:

“...the Legislature has inadvertently overlooked that information may be *readily observable* but not *readily observable* in Australia. Such a construction would defeat the purposes of the Act.”³⁹⁴

In a majority decision, Mason P and Hidden J upheld the appeal. They stated that:

“The fundamental principles of open justice are based on the assumption that everything that happens in open court is capable of being observed and reported upon, thereby ensuring continuing accountability. The requirement that courts sit in public and render themselves accountable through delivery of reasoned judgments proceeds from an assumption that that which happens in open court is capable of reportage to the whole world because it is observable.”³⁹⁵

It is difficult to deduce the full implication of these judgments for an interpretation of ‘general availability’ of information in insider trading (s1002B(2)/1042C), and for continuous disclosure under s1001C(2)/676(2). In a recent article it is stated that the Court of Appeal:

“...has confirmed the uncertainty in the meaning of ‘generally available’ in the insider trading provisions of the *Corporations Act*, particularly in the context of electronic transmissions” and “...it would be preferable if the legislation were amended to address the position with respect to electronic transmissions at least.”³⁹⁶

³⁹² *R v Firms*, note 389 at 32; *ASIC Media Statement* 99/448 2 December 1999; The two decisions concerning Carpenter Pacific Resources NL provide an interesting comparison with ‘general availability’ through a written medium as discussed by Bryson J in *ICAL v County Natwest Securities and Transfield* (1988) 6 ACLC 467; 13 ACLR 129 at 141 (see section on ‘Generally Available’ later in this chapter).

³⁹³ *R v Firms* at 31.

³⁹⁴ *Ibid*, at 119.

³⁹⁵ *Ibid*, at 91.

³⁹⁶ McDonald M ‘*R v Firms* – Insider Trading Update’ (2001) 19 *Company and Securities Law Journal* 337-339 at 337, 339.

A former National Enforcement Director for ASIC, Joe Longo, commented on the Mason P definition of ‘generally available information’ by saying that:

“These issues still await a legislative solution. One thing is clear, the current insider trading provisions cannot remain in their current form.”³⁹⁷

CASAC recommends that the legislation could be strengthened if the ‘publishable information test’ in s1002B(2)(b)(i), or the replacement s1042C(1)(b)(i), is given priority over the ‘readily observable matter test’.³⁹⁸ In addition, to overcome a situation similar to the *Firms* case, the ‘reasonable dissemination period’ requirement of the publishable information test should be ‘extended beyond informed persons to any other person “connected” with a company’.³⁹⁹ The legal definitions could again be tested as ASIC has laid charges of insider trading against two Perth company directors concerning Roehampton Resources NL.⁴⁰⁰ ASIC has also charged two Sydney business men with insider trading in the shares of Qantas Airways Limited.⁴⁰¹

Statutory Tests for Continuous Disclosure and Insider Trading

‘Generally Available’

Section 1001C(2)/676(2) defines information that is ‘generally available’ for the purpose of s1001A(2)(a)/674(2)(c)(i). The definition is identical to guidelines previously introduced in 1991 to the insider trading division of the *Corporations Act*, s1002B(2)/1042C. For the purposes of the continuous disclosure provision, ‘primary information’ is considered to be generally available if it consists of a ‘readily observable matter’.

Both the continuous disclosure provision s1001C(3)/676(3), and the insider trading provision s1002B(3)/1042C(1)(c), accommodate a definition of ‘derived information’. These two provisions contain identical definitions of ‘derived information’ and are authority that information is generally

³⁹⁷ Longo, note 32 at 40.

³⁹⁸ *Insider Trading Discussion Paper*, note 362 at 2.27-32.

³⁹⁹ *Ibid*, at 2.36-39.

⁴⁰⁰ *ASIC Media Release* ‘Michael MacDermott Charged with Insider Trading’ 01/427 30 November 2001; *ASIC Media Release* ‘Robert Martin’ Charged with Insider Trading’ 01/436 7 December 2001.

⁴⁰¹ *ASIC Media Release* ‘Robert Doff Charged with Insider Trading’ 01/435 7 December 2001; *ASIC Media Release* ‘Rene Walter Rivkin Charged with Insider Trading’ 01/439 11 December 2001.

available if it ‘consists of deductions, conclusions or inferences’ drawn from primary information that is ‘generally available’.

The *Financial Services Reform Act* replaces s1001C with s676, which contains an equivalent definition of when information is generally available but excludes the former sub-headings of ‘primary information’ and ‘derived information’. As discussed in the previous section on *Insider Trading Case Law*, CASAC recommends that, in the context of insider trading, priority should be given to the ‘publishable information test’ over the readily observable matter test but there is no suggestion that this interpretation would also apply to s676(2), the replacement of the ‘primary information’ provision s1001C(2).⁴⁰²

ICAL v County Natwest,⁴⁰³ discussed later in the section on *Degree of Materiality*, considered the omission of material from the Part C statement of an on-market takeover. The question of general availability of the material was investigated. The Court expected a high standard of information availability. A government minister had released information concerning a contract and newspapers had disseminated this ministerial announcement. Bryson J failed to find this significant and he set a higher standard of disclosure, at least in takeover documentation. He stated that much of the information in the public domain was unavailable to many members of the public as even those who were better informed could overlook some things. His decision set a standard that:

“...dissemination by news media would be significant only if it carried matters to the point that it was probable that all the holders of shares in the plaintiff had the joint communique disclosed to them in that way; and I find that this is not probable”.⁴⁰⁴

In *SEC v Texas Gulf Sulphur Co*⁴⁰⁵ the Court considered whether information was generally available in the context of insider trading. A similar test could be applied to a ‘reasonable period’⁴⁰⁶ of dissemination as required by s1001C(2)(b)(ii)/676(2)(b)(ii). Merely announcing information is likely

⁴⁰² *Insider Trading Discussion Paper*, note 362 at 2.27.

⁴⁰³ *ICAL v County Natwest Securities and Transfield (Shipbuilding) Pty Ltd*, note 392.

⁴⁰⁴ *Ibid*, at 141.

⁴⁰⁵ *SEC v Texas Gulf Sulphur Company*, note 290.

⁴⁰⁶ ASX estimates that two days is a ‘reasonable period’ for dissemination of an announcement and this period must expire before a four week trading window in its securities can commence. Directors and employees of ASX can only trade during this approved period. Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 37. See section on *ASX Trading and Disclosure Policy* in Chapter 6.

to be insufficient. A reasonable period for it to be disseminated must have elapsed before information can be considered sufficiently disclosed. The Court made no attempt to define this time frame as it depended on the circumstances of the disclosure. Liquidity of the market and the sophistication of the market participants would be necessary considerations in applying this general availability test.⁴⁰⁷

'Material Effect'

A listed company is required to release information to the public only if the disclosure is likely to have a material effect on the price or value of its securities. Following the commencement of the *Financial Services Reform Act*, s677⁴⁰⁸ imposes a 'reasonable person' test on materiality in the same way as former s1001D. Similarly, the replacement s1042D applies instead of s1002C to material effect in an insider trading context.

At the actual time of disclosure the information may have no material effect on the share price. Reasons for this could be that:

- the information is unimportant, of no material value, or
- the information is already absorbed by the market and incorporated into the current share price.⁴⁰⁹

Company announcements and share prices can reveal which of the above possibilities has occurred in a particular situation. However, on occasion it is necessary to form a value judgement about which alternative is the most likely. This value judgement will depend on the 'materiality', the relevance or price-sensitivity, of the information.

Such judgements occur daily at the stock exchange. An officer of ASX Companies evaluates the announcements released to the stock exchange. If a company announcement is considered in the

⁴⁰⁷ *Australian Corporations and Securities Law Reporter* 1996, note 104 at 232-700.

⁴⁰⁸ *Explanatory Memorandum*, note 11 at 18.16 (Note: this paragraph appears to incorrectly state that the proposed s675 defines material effect, rather than s677 as given in the *Financial Services Reform Bill 2001*, note 21, Schedule 2 Continuous Disclosure at 561).

⁴⁰⁹ See section on *Efficient Market Theory* in Chapter 3.

opinion of ASX to be price sensitive,⁴¹⁰ then a ‘notice received’ message will initiate a trading pause to enable the market to absorb the information.⁴¹¹

The materiality of such announcements is central to the continuous disclosure provision and listing rule 3.1. An understanding of judicial application of the term ‘material effect’ will assist when practical evaluation of either price or volume fluctuations is necessary. This is also the initial test that officers of a company will apply when confronting a disclosure decision. Examination of the following judicial decisions is helpful in defining the scope of this and other related terms contained in the provision.

The Supreme Court of South Australia’s appeal decision of O’Loughlin J in *Flavel v Roget*⁴¹² is one of the few to deal with voluntary disclosure of material information to the stock exchange. This contrasts with a number of other cases that evaluate the standard of mandatory information disclosure in a prospectus, a takeover offer or a notice of meeting.

O’Loughlin J discusses the extent to which ASX, under the previous listing rule 3A(1), should be informed of the content of a document within the context of continuous disclosure. The decision recognises that the type of information that is material will depend on the characteristics of a particular company. Disclosure standards can vary from company to company and between the various stages of a company’s development.⁴¹³ The decision in *Flavel v Roget* occurred prior to the introduction of s1001A/674 and at issue was a director’s failure to disclose in a situation where a company’s reply to a stock exchange query was ‘arguably deficient’.⁴¹⁴

Although the director, Roget, failed to clarify the ‘material aspect’ of the agreement in his reply to ASX, trading in the stock was allowed to resume. The Corporate Affairs Commission in South

⁴¹⁰ CASAC (1996), note 26 Appendix 2 at 19 of ‘The Impact of the Enhanced Disclosure Regime on Corporate Disclosure Policies’ (Appendix 8).

⁴¹¹ To initiate the pause in trading the announcements officer will request that the stock be placed in the ‘pre-open’ phase by SEAT Market Control. The halt of approximately ten minutes will be followed by the normal opening procedure. (source: M Aitken, A Frino and R Winn ‘The Effect of Information Motivated Trading Halts on Price Discovery Evidence from the Australian Stock Exchange’ Department of Finance, University of Sydney 1995 at 4.)

⁴¹² *Flavel v Roget* (1990) 1 ACSR 595.

⁴¹³ *Ibid*, at 602-603; *ASX Discussion Paper: Listing Rule 3A(1)*, note 61 at 12.

⁴¹⁴ *Flavel v Roget*, note 412 at 597.

Australia requested ASX to suspend trading in the company's shares, but the stock exchange declined. The Commission then moved to prohibit trading. The lack of action by the stock exchange to again suspend trading could have occurred because the qualified privilege now afforded ASX was not strengthened until September 1994. The stock exchange now has qualified privilege in relation to suspension or removal of securities under s779(8)/1100B.⁴¹⁵

O'Loughlin J supported the principle of general disclosure to ASX, if not specific disclosure in this particular case. Ensuring that the stock exchange is advised of a document:

“...does not mean that it is necessary to state in detail each and every term contained in the document; nor does it mean that it is necessary to supply a copy of the document...it means to advise of its existence and its significance”.⁴¹⁶

In this case the Court did not acknowledge a need for its decision, or the legislation, to reinforce the authority of the listing rules. It could be expected that any current decision based on similar facts would sanction full disclosure to ASX.

The concept that materiality is contained in the quality of disclosure rather than quantity was alluded to in *Fraser v NRMA Holdings Limited*⁴¹⁷. The Full Court of the Federal Court stated that the:

“...need to make full and fair disclosure must be tempered by the need to present a document that is intelligible to reasonable members of the class to whom it is directed, and is likely to assist rather than confuse”.

Degree of Materiality

Information is considered material, in the provisions on ‘material effect’ discussed previously, if it would be likely to influence persons, who commonly invest in securities, in deciding whether or not to subscribe for, or buy or sell the securities. Referral to US case law dealing with insider trading can provide additional tests of materiality. However, one legal practitioner sounds a note of caution as disclosure in the US context is in relation to ‘buying or selling securities, proxy solicitation,

⁴¹⁵ Qualified privilege is discussed in the section on *ASX Enforcement* in Chapter 5.

⁴¹⁶ *Flavel v Roget*, note 412 at 604.

⁴¹⁷ *Fraser and Anor v NRMA Holdings Limited and Others*, note 326.

takeovers and prospectuses'.⁴¹⁸ Although the cases offer useful analysis and examples for Australian Courts, Koeck recommends caution in interpreting disclosure obligations in a different regime.

*TSC Industries Inc v Northway Inc*⁴¹⁹ is US authority for a judicial test where materiality was held to be a function of the size of the effect that an event has on a company. Marshall J, in delivering the opinion of the US Supreme Court, states that there must be:

“...a substantial likelihood that the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available”.⁴²⁰

Cooke J accepts this principle in a New Zealand decision, *Coleman v Myers*,⁴²¹ when he evaluates those matters that are material and should be disclosed under the general law. An evaluation of the materiality of a future event would not only consider the magnitude of the event’s effect on the company’s profitability but should take into account the probability of the event occurring.⁴²² If the effect of the event is considered low on both these evaluations then the information is not material.

Bryson J in *ICAL v County Natwest Securities and Transfield (Shipbuilding) Pty Ltd*,⁴²³ in the Supreme Court of NSW Equity Division, decided that so-called ‘price sensitive’ information supposedly leaked by Macquarie Bank to Fletcher Challenge was not material. He did not ‘regard it as information of importance or value’. He could see no reason why it should not be made public, as the information would have little material effect on the relevant share price.

Reasonable Person Test

Sections 1001A(2)(b)/674(2)(c)(ii) and 1001D/677 refer respectively to information that a ‘reasonable person would expect’ and that ‘a reasonable person would be taken to expect’. Under the

⁴¹⁸ Koeck WJ ‘Continuous Disclosure’ (1995) 13 *Company and Securities Law Journal* 485-512 at 497.

⁴¹⁹ *TSC Industries Inc v Northway Inc* 426 US 438 (1976).

⁴²⁰ *Ibid*, at 449 cited in *Australian Corporations and Securities Law Reporter*, note 104 at 232-700; *Baxt et al* (1996), note 277 at 320.

⁴²¹ *Coleman v Myers* [1977] NZLR 225 at 334.

⁴²² *SEC v MacDonald* 69 9 F 2d 47 at 50 (1st Cir 1983) cited in *Australian Corporations and Securities Law Reporter*, note 104 at 232-7000; *Basic Inc v Levinson* 108 S Ct 978 (1988) cited in *Baxt et al* (1996), note 277 at 321.

⁴²³ *ICAL v County Natwest Securities and Transfield (Shipbuilding) Pty Ltd*, note 392.

latter provision, the ‘reasonable person’ test refers to the reasonable person who would expect the information to influence persons who commonly invest in securities. This standard is used as a guide to compliance with the rule.

To comply with this test, the listed disclosing entity must evaluate whether, in the judgement of a reasonable person, the information would have a material effect on the price of the securities. It must also consider if the information would be likely to influence that class of persons, who commonly invest in securities, to trade or subscribe for those securities. To date, there is little guidance as to whether ‘commonly’ is restricted to traders, analysts and institutional investors, or includes also a private individual who invests only in well publicised floats or the top 50 listed companies.

Information likely to affect the investment decisions of such persons could be potentially material, even if its eventual effect on the market proves not to be so. Mahon J, at first instance in *Coleman v Myers*,⁴²⁴ states that:

“...the test of materiality of disclosure is objective in that the relevant question always is whether there has been non-disclosure of any fact which in reasonable and objective contemplation might affect the value of the security...”⁴²⁵

The standard to be applied to the materiality of undisclosed information could be borrowed from s52 of the *Trade Practices Act*. Deane and Fitzgerald JJ in *Taco Co of Australia Inc v Taco Bell Pty Ltd*⁴²⁶ rely on an expansive reasonable person test, used by Lockhart J in *Puxu Pty Ltd v Parkdale Custom Built Furniture Pty Ltd*.⁴²⁷ The class of ‘reasonable’ persons that is likely to be misled or deceived is wide, it includes ‘the astute and the gullible, the intelligent and the not so intelligent, the well educated as well as the poorly educated, men and women of various ages pursuing a variety of vocations’.⁴²⁸

⁴²⁴ *Coleman v Myers*, note 421 at 225.

⁴²⁵ *Ibid*, cited in Baxt R, K Fletcher and S Fridman *Afterman & Baxt’s Cases and Materials on Corporations and Associations* Sydney Butterworths 8th ed 1999 at 473.

⁴²⁶ *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177 at 202.

⁴²⁷ *Puxu Pty Ltd v Parkdale Custom Built Furniture Pty Ltd* (1980) 31 ALR 73.

⁴²⁸ *Ibid*, at 93.

The Full Court of the Federal Court, in *Fraser v NRMA Holdings Ltd*,⁴²⁹ again recognises a broad spectrum of ‘reasonable people’. The class of persons to whom a prospectus disclosure is directed could include significant numbers of people who, while quite astute in dealing with their daily financial affairs, have no experience in dealing with shares.

Are these s52 tests too wide to represent the ‘reasonable person’ whose standards are a guide to what is considered ‘material’ in information disclosure? Subscriptions to popular share floats would suggest that these s52 tests are appropriate. The addition to the Official List of companies with public appeal has greatly broadened the potential shareholder base. ASX’s *Share Ownership 2000* survey reveals that 7.6 million Australians, or 53.7 per cent of the adult population, have some exposure to the Australian share market. Of these investors, 5.7 million are involved in direct share investment.⁴³⁰

ASX Authority

At the conclusion of his history of the Sydney Stock Exchange, Professor Stephen Salsbury stated that the exchange had been surprisingly innovative. The stock exchange’s listing rules had ‘long run ahead of the demands of the various colonial and state company laws and so it helped instil confidence in Australian securities’.⁴³¹

Prior to the formation of ASX on 1 April 1987, a degree of unity between the various state stock exchanges meant that they were able to demand adherence to the listing rules. On occasion, large companies would fail to comply, as they were aware that any action by the exchange to suspend securities or delist the company could lead to lower market turnover. This rebellion risked the relevance of ‘on-change’ trading and even the viability of the stock exchange.

Adamson⁴³² points out that News Limited received a ‘testy letter’ from the chairman of the Melbourne Stock Exchange for announcing a new issue through the press prior to advising the exchange. It is understood that this threat of non-compliance from large or popular corporations still

⁴²⁹ *Fraser and Anor v NRMA Holdings Limited and Others*, note 326.

⁴³⁰ ASX Investor Relation News *Media Statements* 8 February 2000.

⁴³¹ Salsbury and Sweeney, note 56 at 453.

⁴³² Adamson, note 384 at 60. (Listing rule 15.7 states that an entity must not release information that is for release to the market until it has given the information to ASX.)

exists to some extent, in spite of legislative support for the listing rules (ss777/793C, 1114/1101B) and particularly for the continuous disclosure rule 3.1 with separate statutory backing from the continuous disclosure provision.

The first *Securities Industry Act* 1970 (NSW) was effective 8 April 1970, just as the mining boom of the late 1960s was ending.⁴³³ The legislation concentrated mainly on regulation of stockbrokers and their relationships with clients and the stock exchange. This was the first major encroachment on the stock exchange's self-regulation. Shortly afterwards, in July 1970, the Rae Committee⁴³⁴ began its examination of the securities industry.⁴³⁵ The Committee's report was released on 18 July 1974⁴³⁶ and was scathing in its criticism of the industry. As a result, revised legislation was introduced and the *Securities Industry Act* 1975 (NSW) added statutory enforcement to the listing requirements from 1 March 1976.

The stock exchanges were still responsible for initiating and amending these rules but the government had a period of time in which it could disallow implementation of the rules. Provisions to prohibit market manipulation⁴³⁷ and to extend the earlier insider trading provision⁴³⁸ were introduced into the legislation. In 1980, this legislation was subsequently incorporated into the *Companies Code*, and a decade later formed the basis of Chapter 7 on Securities in the *Corporations Law* and then the *Corporations Act*.

Section 1001A/674 states that a listed disclosing entity must comply with the listing rules of a securities exchange or a listing market on matters of disclosure. The securities exchange, ASX, is

⁴³³ Poseidon NL reached a peak of \$280 per share on 12 February 1970 as cited in Salsbury and Sweeney, note 56 at 353.

⁴³⁴ Senate Select Committee on Securities and Exchange, chairman Senator Peter E Rae.

⁴³⁵ Salsbury and Sweeney, note 56 at 371.

⁴³⁶ Parliament of the Commonwealth of Australia *Australian Securities Markets and their Regulation* Report from the Senate Select Committee on Securities and Exchange Part 1 Canberra AGPS 1974, Part 2 1974, Part 3 1975 (Rae Report); Salsbury and Sweeney, note 56 at 405; Baxt *et al* (1996), note 277 at 302; Redmond P *Companies and Securities Law* Sydney 2nd ed Law Book Company 1992 at 56.

⁴³⁷ Salsbury and Sweeney, note 56 at 422-424; Baxt *et al* (1996), note 277 at 302.

⁴³⁸ Baxt *et al* (1996), note 277 at 310; Insider trading was initially prohibited by s75A of *Securities Industry Act* 1970 (NSW).

initially responsible for enforcing compliance with the rules. At times, the extent of the stock exchange's authority to enforce compliance has been uncertain.

Wider Interpretation of the Rules

The decision of Street J in the New South Wales Supreme Court in Equity, in *Kwikasair Industries Ltd v Sydney Stock Exchange Ltd*,⁴³⁹ firmly based the stock exchange's right to suspend securities or remove a company on the agreement between the two parties. The rights of the parties emanate from the context in which agreements are made for the listing of securities on the stock exchange's Official List.⁴⁴⁰ In *FAI Insurances Ltd v Pioneer Concrete Services (No 2)*,⁴⁴¹ in the Supreme Court of New South Wales, Kirby P supported a wider interpretation of the authority of the stock exchange than had previously been recognised. Prior to the introduction of the *Companies Code*, there was less appreciation of the power of the stock exchange to enforce its listing rules.

Under the old *Securities Industry Act 1975*, Kirby P held:

“...it was necessary to establish outside the section [the former equivalent of s777/793C of the *Corporations Act*], a contractual or statutory obligation to observe the listing requirements...but the *Securities Industry Code* imposes its duties more clearly. By force of the section it gives statutory recognition and significance to the listing requirements”.⁴⁴²

Kirby P disagreed with the decision of Young J at first instance. Young J saw the listing requirements as only:

“...a flexible set of guidelines for commercial people to be policed by commercial people...principles to be administered and applied by an expert body in accordance with the prevailing ethos of those chosen to administer them”.⁴⁴³

⁴³⁹ *Kwikasair Industries Ltd v Sydney Stock Exchange Ltd* (1968) ASLC 30,701 reprinted in *Australian Corporations and Securities Law Reporter*, note 104, 1998 at 303;721-303;753; Redmond (1992), note 436 at 898; Baxt *et al* (1996), note 277 at 171.

⁴⁴⁰ *Ibid*, *Kwikasair* at 30,708.

⁴⁴¹ *FAI Insurances Ltd v Pioneer Concrete Services (No 2)* (1986) 10 ACLR 801.

⁴⁴² *Ibid*, at 810.

⁴⁴³ *Ibid*, at 811.

This approach undervalues the special statutory recognition that is now accorded to the stock exchange rules, first by the *Companies Code* and then by the *Corporations Act* under s777/793C and s1114/1101B. In a later case, *Hillhouse v Gold Copper Exploration NL*,⁴⁴⁴ Macrossan J acknowledges the shift in emphasis of s42 of the *Companies Code*, equivalent to s777/793C of the *Corporations Act*, which was recognised by Kirby P in *FAI*.⁴⁴⁵

A broad interpretation of the authority of the listing rules was again recognised in *TNT Australia Pty Ltd v Poseidon Limited (No 2)*.⁴⁴⁶ In the Supreme Court of South Australia, Jacobs J held that a notice of meeting was invalid when it failed to give full and fair disclosure of a proposed merger. He supported the right of ASX to enforce the ‘spirit’ of the listing rules by demanding greater disclosure:

“The Rules by which the defendant is bound, state in an introduction that the Stock Exchange, in administering the Rules, ‘looks to companies to comply with the spirit as well as the letter of those Rules’ and I think that in a commercial document such as this it ought to be construed and interpreted by a Court in such a way as to give effect to the spirit and the purpose of the Rule.”⁴⁴⁷

Contractual Obligation of the Listing Rules

In spite of the wording of s777/793C and s1114/1101B, which is discussed more fully in the next section, one view is that the intention of the *Corporations Act* is to stop short of making the ASX listing rules enforceable as statutory obligations. Magarey⁴⁴⁸ argues that the essence of these provisions is still the prior contractual obligation between the two parties, the listed company and the stock exchange.

Courts have long acknowledged this contractual obligation to comply with the listing rules. In *Ampol Petroleum Ltd v RW Miller Holdings Ltd*,⁴⁴⁹ Street CJ considered it:

⁴⁴⁴ *Hillhouse v Gold Copper Exploration NL* (1988) 14 ACLR 423 at 433.

⁴⁴⁵ *FAI Insurances Ltd v Pioneer Concrete Services (No 2)*, note 441.

⁴⁴⁶ *TNT Australia Pty Ltd v Poseidon Limited (No 2)* (1989) 15 ACLR 80.

⁴⁴⁷ *Ibid*, at 85.

⁴⁴⁸ Magarey D ‘Enforcement of the Listing Rules of the ASX’ (1995) 13 *Company and Securities Law Journal* 6-30 at 6.

⁴⁴⁹ *Ampol Petroleum Ltd v RW Miller Holdings Ltd* [1972] 2 NSWLR 850.

“...common ground that Miller was bound by contract to the Stock Exchange to observe the rule”.⁴⁵⁰

Lord Wilberforce for the Privy Council affirmed this on appeal. He held that an issue of shares to Howard Smith was in contravention of the stock exchange regulations:

“...which moreover have contractual force”.⁴⁵¹

In October 1992, ASX issued its *Exposure Draft of Proposed Listing Rule Amendments and Other Issues*.⁴⁵² One of the proposals was listing rule 3J(37). The rule would require every director and secretary of a listed company to enter into a written undertaking with ASX. This agreement would acknowledge that a company was contractually bound to comply with all aspects of the listing rules.⁴⁵³ However, the stock exchange would continue to have absolute discretion to grant a waiver of a particular rule at the request of a listed company.⁴⁵⁴

Appendix 16A of the listing rules, effective 1 July 1996 and now replaced by an expanded Appendix 1A,⁴⁵⁵ is evidence of this contractual arrangement. The secretary and a director of the company should execute the standard form agreement under the company’s seal. The terms are more comprehensive than those of the original draft contract. The agreement now recognises the absolute discretion of ASX to quote, suspend and remove securities from trading on the stock exchange. The company also agrees to ASX’s discretion to grant a waiver of a particular rule. There is a contractual obligation to comply with the ‘spirit’⁴⁵⁶ of the listing rules and to indemnify the stock exchange for any claim, action or expense arising from breach of the contract.⁴⁵⁷

⁴⁵⁰ Ibid, at 881.

⁴⁵¹ *Howard Smith v Ampol Ltd (PC)* [1974] AC 821 at 838.

⁴⁵² Australian Stock Exchange Limited *Exposure Draft of Proposed Listing Rule Amendments and Other Issues* October 1992 at 61.

⁴⁵³ Magarey, note 448 at 14.

⁴⁵⁴ Ibid, at 15.

⁴⁵⁵ Appendix 16A was deleted 1 July 1997 and amended to form Part 3 of Appendix 1A, General Admission Application and Agreement, *ASX Listing Rules* issued 1 July 2000.

⁴⁵⁶ Ibid, Appendix 1A at clause 6 (clause 4 when issued 1 July 1996).

⁴⁵⁷ Ibid, Appendix 1A at clause 3.

Emphasising a broader interpretation of the ‘spirit’ of the ASX listing rules is in keeping with the ‘purposive’ construction required by former s109H. Since the introduction of the *Corporations Act* 2001, s15AA of the *Acts Interpretation Act* replaces s109H of the *Corporations Law*. This interpretation of the provisions of the *Corporations Act* will prefer a construction that promotes the purpose or object underlying the law, whether that purpose or object is expressly stated or not.

Some elements of the Appendix 1A agreement have led to argument that the legal framework of the relationship between ASX and the listed company is so:

“...indeterminate as to raise the question of whether it creates a binding obligation upon either the ASX or the listed company”.⁴⁵⁸

The traditional doctrine of contract demands certainty by both parties of the terms of the contract. A degree of uncertainty is added to an Appendix 1A agreement by the absolute discretion that ASX reserves for itself to enable it to administer the rules more effectively. The exercise of this discretion, to grant a waiver of a company’s obligation under a particular rule, could be viewed as an alteration by only one party of a term of the agreement.⁴⁵⁹

Sections 777/793C and 1114/1101B

Prior to the legislative amendments of the 1990s, ASX saw itself as having a narrow but significant role in regulating listed companies. Its authority was based on the willingness of companies to undertake an obligation and enter into a contract with ASX to ensure compliance with the listing rules.⁴⁶⁰ The principal enforcement procedures available to the stock exchange, in increasing degrees of severity, were to suspend trading in a company’s securities, to seek a Court order under ss777/793C or 1114/1101B of the *Corporations Act* to enforce compliance with the rules, or to remove the company from the Official List.

Where there is an infringement of an ASX listing rule, the stock exchange has the contractual right under the Appendix 1A agreement to suspend a company’s securities from trading or remove the

⁴⁵⁸ Spender P ‘The Legal Relationship between the ASX and Listed Companies’ (1995) 13 *Company and Securities Law Journal* 240-275 at 240.

⁴⁵⁹ Ibid, at 241.

⁴⁶⁰ Lavarch Report, note 1 par 2.4.11.

company from the Official List. However, ASX does not always wish to take this action, as it would deny market access to investors and shareholders of the company.

The *Securities Industry Act* 1975 (NSW) introduced a provision for the enforcement of the listing rules by an earlier version of s777/793C. Section 777(1)/793C(1), (2), in Part 7.2 of the *Corporations Act* states that an application may be made to the Court by ASIC, ASX or a person aggrieved to obtain an order of compliance with, or enforcement of, the relevant operating rules, in this instance the ASX listing rules. The original provision was amended with the introduction of continuous disclosure in September 1994 to clarify the definition of a ‘person aggrieved’.

A company, by agreeing to have its securities included on the Official List of the stock exchange, is deemed to ‘be under an obligation to comply with... a licensed market’s operating rules’ (s793C(1)). This obligation arises from the contractual obligation to comply with the listing rules, as discussed in the previous section.

Section 1114(1)/1101B(1) is a miscellaneous provision in Part 7.12 of the *Corporations Act*. A companion to s777/793C, it is also concerned with the power of the Court to make certain orders (s1101B(4)) for a contravention on the application of ASIC or ASX. Also effective 5 September 1994, s1114/1101B was further amended to complement s777/793C by extending to a ‘person aggrieved’ the right of application to the Court (s1101B(1)(d)).

Both these provisions specify that the Court may direct a person, or the directors of a body corporate, to comply with the listing rules of the stock exchange (ss793C(2)(b) and 1101B(4)(b)). An infringement of the listing rules is not an offence under either provision. However, s1114(8)/1101B(10) states that a contravention without reasonable excuse of an order of the Court can result in a fine and imprisonment.⁴⁶¹ These seldom used powers of the stock exchange under the statute existed prior to the introduction of s1001A/674 penalties in 1994. They could still be utilised to penalise a company in a case of persistent non-compliance with listing rule 3.1.

⁴⁶¹ Schedule 3 Penalties: 100 penalty units or imprisonment for two years or both. Penalties for bodies corporate are five times the maximum pecuniary penalty for that offence (s1312). A penalty unit is \$110 (s4AA of the *Crimes Act* 2001 (Cth)).

Judicial Review of an ASX Decision

Can a listed company apply to the Courts for a review of an ASX decision? French J in *Kalmet Resources NL v Australian Stock Exchange*⁴⁶² agreed with the plaintiff company that ASX had been misleading under s52 of the *Trade Practices Act*. The stock exchange had announced the post-reconstruction exercise price of an option as \$2.50 instead of 20 cents. Although the stock exchange had cross-claimed against the company for alleged breach of the listing rules, the Court did not proceed to findings on this matter. French J did point out that ASX operated in a system of self-regulation, so the Court should not be the ‘first resort’ to determine whether there had been a contravention of the listing rules.

Where does a company go as a ‘first resort’ if it is dissatisfied with the outcome of an ASX decision concerning the listing rules? Prior to the demutualisation of ASX in 1998, there was a right of appeal to ASX’s National Listing Committee against a decision of the Companies section of ASX. This committee has since been disbanded and replaced with the Listings Appeals Committee.⁴⁶³ There is also authority that the government regulator can take action when it is not satisfied with an ASX ruling.⁴⁶⁴

The English case, *Datafin*,⁴⁶⁵ is authority that the Courts will consider judicial review on a question of law, against a decision of a self-regulatory body similar to the stock exchange. The issue decided in *Datafin* concerned a self-regulatory Panel on Takeovers and Mergers, which administered the takeover code in the United Kingdom. As Sir John Donaldson MR said in the Court of Appeal, Civil Division:

“...the issue is whether the historic supervisory jurisdiction of the Queen’s Court extends to such a body discharging such functions including some which are quasi judicial in their nature”.⁴⁶⁶

⁴⁶² *Kalmet Resources NL v Australian Stock Exchange Limited and Australian Stock Exchange (Perth) Limited* 13 July 1992 Federal Court of Australia No 505 (unreported).

⁴⁶³ Australian Stock Exchange Limited *Annual Report 1998* at 3 and 1999 at ‘Corporate Governance’.

⁴⁶⁴ *Flavel v Roget*, note 412, as discussed above in the earlier section on ‘Material Effect’.

⁴⁶⁵ *R v Panel on Takeovers and Mergers, ex parte Datafin plc and Prudential Bache Securities Inc of NY* [1987] 1 All ER 564.

⁴⁶⁶ *Ibid*, at 575.

Lloyd and Nicholls LJ agreed with Sir John Donaldson that leave to apply for judicial review should be granted even though the substantive application was subsequently dismissed. The Court did not accept that its jurisdiction for judicial review only extended to bodies whose powers were derived from legislation or the exercise of the prerogative.

The takeover Panel did not have direct statutory or prerogative powers. The Court considered this an anomaly, as it was a government decision that had led to the formation of the Panel. Unlike ASX, there was no common law contractual basis to the Panel's authority over companies. However, most of the companies that came before the Panel were listed on the LSE. As a result, the Panel derived support for its authority from the powers and duties of the Council of the Stock Exchange.⁴⁶⁷

In *Datafin*, the unanimous decision of the Court was that the Panel, although self-regulatory, was subject to judicial review in restricted circumstances. The Court's jurisdiction was to be used only if the Panel 'reached a decision in flagrant breach of the rules of natural justice'.⁴⁶⁸ Sir John Donaldson MR could only anticipate:

“...the use of the remedies of certiorari and mandamus...in the event, which I hope is unthinkable, of the panel acting in breach of the rules of natural justice, that is unfairly”.⁴⁶⁹

It would seem that *Datafin* provides a persuasive precedent by which the Courts could review a decision of ASX on a question of law.⁴⁷⁰ The ability of the Courts to review a decision taken by ASX, under the discretionary power accorded to it in the listing agreement and rules, was at the core of the appeal in the *Chapmans* case.⁴⁷¹

ASX, after giving notice to Chapmans that it did not have sufficient spread of shareholdings, suspended the company in August 1992. Chapmans was notified that it would be removed from the Official List on 1 December 1993 unless it appealed against the ASX decision by that date. The

⁴⁶⁷ Ibid, Nicholls LJ at 587.

⁴⁶⁸ Ibid, Lloyd LJ at 582.

⁴⁶⁹ Ibid, Sir John Donaldson MR at 579.

⁴⁷⁰ Baxt *et al* (1996), note 277 at 158: The authors cite *Datafin* and suggest that an ASX decision could be subject to review under administrative law rules.

⁴⁷¹ *Chapmans Limited v Australian Stock Exchange Limited* (1996) 21 ACSR 295 Appeal to the Federal Court of Australia - General Division. Lockhart, Sheppard and Hill JJ, from the decision by Beaumont J in *Chapmans Limited v ASC* (1994) 12 ACLC 512.

company lodged a notice of appeal on that date and also commenced proceedings seeking a review of the ASX decision under the provisions of the *Administrative Decisions (Judicial Review) Act 1977* (Cth), (ADJR Act).

Beaumont J, at first instance, agreed with ASX that the ADJR Act did not apply to a decision to delist a company, as the decision was not made ‘under an enactment’⁴⁷² but by the power of the stock exchange listing rules. The appeal by Chapmans against this decision was dismissed. The Court held that a reference to the listing rules in the *Corporations Act* did not mean that the rules were made ‘under’ that legislation.⁴⁷³

Although ASX owes its existence to statute and is deemed to have been registered under s40(4) *Companies Act* 1981 (Cth),⁴⁷⁴ there needs to be sufficient proximity between a decision of ASX and the legislation to:

“...permit the decision to be characterised as one made under the enactment...

The fact that the listing rules are referred to in the legislation does not mean that they are made under it. More than identification in a statute is required before an instrument can be said to be one made under a statute”.⁴⁷⁵

The decision in *Chapmans* strengthens the authority of the stock exchange to discipline a listed company by suspension of its securities or removal from the Official List. The Court confirmed the decision of Street J in *Kwikasair*⁴⁷⁶ that the stock exchange has the ‘power of summary removal’.

Exemptions by the Commission

ASIC has the authority to exempt specified persons from all or part of the disclosing entity provisions (s111AR(1)). Conditions may be attached to these exemptions (s111AT(1)). This ASIC power would override the authority of ASX to enforce disclosure under the listing rules. Exemptions could encompass both the periodic reporting and continuous disclosure obligations of listed disclosing entities.

⁴⁷² Ibid, at 295.

⁴⁷³ Ibid, at 296.

⁴⁷⁴ *Australian Stock Exchange and National Guarantee Fund Act* 1987 (Cth) s36C(1).

⁴⁷⁵ *Chapmans Limited v Australian Stock Exchange Limited*, note 471 at 302-303.

⁴⁷⁶ *Kwikasair*, note 439; Redmond (1992), note 436 at 898; Baxt *et al* (1996), note 277 at 171.

ASIC's Policy Statement 95 indicates circumstances in which the regulator would consider relief from the periodic reporting provisions. However, this Policy Statement gives no example of relief for a listed disclosing entity from the continuous disclosure provision, in spite of a specific reference to s674 in s111AR(1)(d). The Commission's policy is that disclosing entities listed on ASX 'have the benefit of clear exceptions to disclosure in listing rule 3.1 and therefore, should not require relief from s1001A/674 under an exception granted by ASIC'.⁴⁷⁷ ASIC will rely on the stock exchange's primary supervision of continuous disclosure and it is unlikely to grant relief for non-disclosure to a listed company if ASX has already refused to grant a waiver of listing rule 3.1.

Section 1001A/674 Liability

The continuous disclosure provision, s1001A/674, was effected from 5 September 1994 to complement the increasingly detailed periodic disclosure⁴⁷⁸ required by the ED regime. The aim of the provision was to reinforce compliance with ASX listing rule 3.1 by the addition of statutory penalties⁴⁷⁹ for intentional breach of s1001A(3)/674(2) Note 1.

The former s1001A(2) stated that a listed disclosing entity must not contravene the disclosure listing rule by 'intentionally, recklessly or negligently' failing to notify the securities exchange of material information. A contravention of this provision would only be considered an offence for the purposes of criminal penalties if the failure to disclose was considered intentional or reckless. Such non-disclosure could incur criminal liability under s1312 penalties for bodies corporate, or s1311 for individuals, and Schedule 3.⁴⁸⁰

Section 5 of the *Crimes Act* 1914 (Cth), extended criminal liability to 'any person', for example directors, senior officers or advisers, who aided, abetted, counselled, procured or were directly or indirectly knowingly concerned with the offence. However, s5 of the *Crimes Act* was repealed from

⁴⁷⁷ 'Disclosing Entity Provisions Relief' note 83 at Part V: Relief from the continuous Disclosure Provisions par 95.49(a); Koeck, note 418 at 492.

⁴⁷⁸ See section on *Periodic Disclosure* in Chapter 2.

⁴⁷⁹ Schedule 3 penalties, note 19.

⁴⁸⁰ Schedule 3 Penalties, note 19.

the commencement of the *Criminal Code* on 15 December 2001.⁴⁸¹ The elements of s5 are replicated in s11.2 of the *Criminal Code*.

From the commencement of the *Financial Services Reform Act*, the fault elements in former ss1001A(2) and (3) are omitted from the new s674. Instead, s678 applies the *Criminal Code*⁴⁸² to an offence based on ss674(2), 674(5) or 675(2).⁴⁸³ ‘Note 1’ under the relevant provision indicates that a failure to comply with the subsection is an offence. The s1311, or 1312, and Schedule 3 penalties remain unchanged for offences under these new provisions. Section 674(5) includes an obligation for listing rules to be made available to a listed disclosing entity. Failure by a market operator to ensure this is an offence but carries the lesser penalty of 100 penalty units.⁴⁸⁴

The *Criminal Code*, contained in the Schedule of the *Criminal Code Act 1995* (Cth), applies ‘on and after the 15 December 2001’⁴⁸⁵ to all offences against Commonwealth law, including the *Corporation Act* as amended by the *Financial Services Reform Act*. Division 3 of the *Criminal Code* ‘divides an offence into “physical elements” and “fault elements”, which essentially replicate the common law concepts of “actus reus” and “mens rea”’⁴⁸⁶. The prosecution bears the legal burden of proving ‘every element of an offence’ beyond a reasonable doubt.⁴⁸⁷

The physical element of an offence may be conduct,⁴⁸⁸ where “conduct” means an act, an omission to perform and act or a state of affairs⁴⁸⁹ and could apply to a failure by a listed disclosing entity to provide material information under s674(2). The fault element for a particular physical element may

⁴⁸¹ *Crimes Act 1914* (Cth) Note 5: *Law and Justice Legislation Amendment (Application of Criminal Code) Act 2001* (Cth) Schedule 51 s4.

⁴⁸² *Criminal Code Act 1995* (Cth).

⁴⁸³ *Explanatory Memorandum*, note 11 at 18.11.

⁴⁸⁴ *Financial Services Reform Bill 2001*, note 21, Schedule 2 Continuous Disclosure at 562 (Schedule 3).

⁴⁸⁵ *Criminal Code Amendment (Application) Act 2000* (Cth) Schedule 1 – Amendment of the *Criminal Code Act 1995* s1.

⁴⁸⁶ Longo, note 32 at 12.

⁴⁸⁷ *Criminal Code* ss13.1(1) and 13.2(1).

⁴⁸⁸ *Ibid*, s4.1(1)(a).

⁴⁸⁹ *Ibid*, s4.1(2).

be ‘intention, knowledge, recklessness or negligence’. This contrasts with the former s1001A(3) where a contravention was ‘only an offence if the failure concerned is intentional or reckless’. The *Criminal Code* extends the fault element to ‘negligence’ if the conduct involves ‘such a great falling short of the standard of care that a reasonable person would exercise in the circumstances’ and ‘such a high risk that the physical element exists or will exist’.⁴⁹⁰

Division 12 recognises corporate criminal liability by stating that ‘this Code applies to bodies corporate in the same way that it applies to individuals’.⁴⁹¹ This reflects s4B(1) of the *Crimes Act*, which states that:

‘...offences shall, unless the contrary intention appears, be deemed to refer to bodies corporate as well as to natural persons’.

The *Criminal Code*⁴⁹² specifically refers to the fact that the *Crimes Act*⁴⁹³ enables a fine to be imposed for offences that only specify imprisonment as a penalty. Where this refers to a body corporate that is convicted of an offence, a pecuniary penalty not exceeding five times the amount that could be imposed on a natural person is applicable.⁴⁹⁴

If there is non-compliance by an employee, agent or officer of the company acting within the scope of designated authority, then the physical element of an offence ‘must also be attributed to the body corporate’, subject to a due diligence defence to prevent the conduct.⁴⁹⁵ To fall within the fault element of intention, knowledge or recklessness, the company must ‘expressly, tacitly or impliedly’⁴⁹⁶ authorise or permit the offence. This permission could emanate from the board of directors or senior management, or it could arise as a result of a ‘corporate culture’⁴⁹⁷ that failed to require compliance and tolerated non-compliance.

⁴⁹⁰ Ibid, ss5.5(a) and (b).

⁴⁹¹ Ibid, s12.1(1).

⁴⁹² Ibid, s12.1 Note.

⁴⁹³ *Crimes Act* ss4B(2) and (3).

⁴⁹⁴ *Crimes Act* s4B(3) and *Corporations Act* s1312.

⁴⁹⁵ *Criminal Code* ss12.2, 12.3(2)(b), 12.3(3) and 12.3(6).

⁴⁹⁶ Ibid, ss12.3(1)

⁴⁹⁷ Ibid, s12.3(6): corporate culture is defined as an attitude, policy, rule, course of conduct or practice existing within the body corporate.

The fault element of negligence can exist if the conduct of the company is negligent, when viewed as a whole through the conduct of its employees and officers. Negligence may be evident if the prohibited conduct is substantially attributable to inadequate corporate management, control and supervision or a failure to provide adequate systems for conveying relevant information.⁴⁹⁸

A breach of the continuous disclosure rule will often be associated with a failure by the company to maintain confidentiality of the price sensitive information. Such an environment is conducive to insider trading, where a conviction under former s1002G, or the amended ss1043A(1) and (2), will also impose criminal liability under s1311 and Schedule 3.⁴⁹⁹ Section 1043A(3) confirms the application of the *Criminal Code* to an offence based on the prior subsections and indicates that the physical elements are contained in ss1043A(1)(a) and (2)(a), while the fault elements of ‘knows or ought reasonable to know’ are contained in ss1043A(1)(b) and (2)(b).⁵⁰⁰

Section 1005/1041I

Section 1005/1041I provides an avenue of recovery of loss or damage resulting from a contravention of Part 7.10 ss1041E-1041H of the *Corporations Act*. Contraventions of the former Part 7.11 included failure to disclose, misleading and deceptive conduct, market manipulation and insider trading, in addition to matters of non-disclosure. The former s1005 was modelled on the damages remedy in s82 of the *Trade Practices Act* and had the potential to expose directors of a company to a civil damages claim by the company or investors who have been forced to trade in an uninformed market.

Formerly, if a person has suffered loss or damage as a result of a contravention of s1001A(2) by a listed disclosing entity, then a civil action for damages may be taken ‘against that other person or against any person involved in the contravention’ under s1005.

Civil liability can be extended to any person who is ‘involved in a contravention’ of the continuous disclosure provision by s79 of the *Corporations Act*. Section 79 has a similar construct to former s5 of the *Crimes Act*, as discussed above, and imposes liability on any person who aids, abets, counsels

⁴⁹⁸ Ibid, ss12.4(2)(b) and 12.4(3)(a), (b).

⁴⁹⁹ Financial Services Reform Bill 2001, note 21, Schedule 1 Financial Services and Markets Part 2 at 550.

⁵⁰⁰ *Revised Explanatory Memorandum*, note 11 at 15.24.

or procures or is directly or indirectly knowingly concerned in a contravention. The concepts of ‘inducing’ or ‘conspiring’ are additional inclusions in s79. This provision has the effect of extending civil liability to directors and senior officers who may be responsible for the failure of a disclosing entity to notify ASX of relevant information.

There is guidance on the interpretation of s79 of the *Corporations Act* in the judicial discussion on the phrase ‘knowingly concerned in or a party to a contravention’ contained in s75B of the *Trade Practices Act*. This phrase imputes to the offender requisite knowledge of the contravention.⁵⁰¹ In the High Court decision, *Yorke and Anor v Lucas*,⁵⁰² Mason ACJ, Wilson, Deane and Dawson JJ held that:

“...a person was not knowingly concerned in a contravention unless he or she is an intentional participant, the necessary intent being based upon the essential elements of the contravention”.

Civil liability under s1041I, the replacement for s1005, no longer applies to the new continuous disclosure provision (s674) or insider trading provision (s1043A) following the commencement of the *Financial Services Reform Act*. Section 1041I enables civil action for loss or damage to be taken for contraventions of ss1041E to 1041H, which include false or misleading statements, inducing persons to deal, dishonest conduct and misleading or deceptive conduct. As discussed in the following section, a number of the amended ‘prohibited conduct’ provisions are included in the expanded civil penalty regime from March 2002.

Civil Penalties

Civil penalties were unavailable under s1001A but the amended continuous disclosure provision, s674(2), is a civil penalty provision under the extended s1317E(1)(ja). This expanded regime offers another enforcement procedure in keeping with the ‘responsive regulation’ suggested by Ayers and Braithwaite and discussed later in this chapter.⁵⁰³ Civil penalties replace s1005/1041I civil liability and provide an alternative to criminal liability and Schedule 3 penalties.

⁵⁰¹ Koeck, note 418 at 506.

⁵⁰² *Yorke and Anor v Lucas* (1985) 158 CLR at 670.

⁵⁰³ Ayers I and J Braithwaite *Responsive Regulation - Transcending the Deregulation Debate* New York Oxford University Press 1992.

There are differing attitudes to penalties for breaches of the *Corporations Act*. According to Tomasic,⁵⁰⁴ the corporate law in Australia has evolved within a ‘civil law culture’ and he argues that heavy reliance on criminal liability is unlikely to be effective for such contraventions. Tomasic canvassed the opinions of 130 practitioners from within the corporate arena and, with the exception of the prosecutors and liquidators, it was:

“...felt that criminal law should have marginal significance in regard to corporate conduct and that much of [the] *Corporations Act* should actually be decriminalised”.⁵⁰⁵

Other arguments against the imposition of criminal liability include the non-violent nature of the offence, costs and delays involved in a criminal prosecution, particularly as the criminal standard of proof renders the possibility of a conviction less certain.⁵⁰⁶

Discretionary civil sanctions are already available under the injunctive remedy, prohibitory and mandatory, of s1324. Compensation for loss can be obtained through the civil liability of s1005/1041I for contraventions of ss1041E-1041H and administrative remedies may be utilised by the Commission under the ASIC Act. In addition to these remedies, and statutory criminal liability, Goldwasser recommended the introduction of a civil penalty regime. All remedies ‘should be cumulative rather than mutually exclusive...providing an explicit pyramid of sanctions’.⁵⁰⁷

It was argued that the availability of civil penalties was one of the main explanations for the success of the SEC in dealing with insider trading in the US. Goldwasser proposed a similar civil penalty regime for contraventions of the former market manipulation provisions, s999 and s1000. Civil penalties would provide a greater range of sanctions for breaches of the continuous disclosure provision and insider trading, in addition to prohibitions of market manipulation.

Part 9.4B of the *Corporations Act* provides a guide to a penalty regime with a civil standard of proof. This standard is based on a balance of probabilities, rather than the criminal standard of beyond

⁵⁰⁴ Tomasic R ‘Corporations Law Enforcement Strategies in Australia: The Influence of Corporate and Bureaucratic Cultures’ (1993) 3 *Australian Journal of Corporate Law* 192-229 at 192.

⁵⁰⁵ *Ibid*, at 205.

⁵⁰⁶ Goldwasser VR ‘The Regulation of Stock Market Manipulation - A Blueprint for Reform’ (1998) 9 *Australian Journal of Corporate Law* 109-157 at 116; V R Goldwasser ‘CLERP 6 - Implications and Ramifications for the Regulation of Australian Financial Markets’ (1999) 17 *Company and Securities Law Journal* 206-219 at 413.

⁵⁰⁷ *Ibid*, Goldwasser (1998) at 121.

reasonable doubt. The civil penalty provisions listed under s1317E⁵⁰⁸ encompass a number of compliance issues including general director's duties (ss180-183) and the duty to prevent insolvent trading (s588G(2)). The list of provisions subject to civil penalties was expanded following the CLERPA amendments on 13 March 2000.

The list is now subject to further amendment under the *Financial Services Reform Act* to include continuous disclosure with the existing civil penalty provisions under the heading 'corporation/scheme civil penalty provisions'. Insider trading and the market manipulation provisions are amended to include all financial products and comprise a new group of civil penalty provisions under the heading 'financial services civil penalty provisions':

- *Corporation/scheme civil penalty provision*

Continuous disclosure ss674(2) or 675(2) under s1317E(1)(ja)

- *Financial services civil penalty provision*

Market manipulation ss1041A to 1041D under s1317E(1) (jb) to (je);

Insider trading s1043A(1) under s1317E(1)(jf) and

Insider trading s1043A(2) under s1317E(1)(jg)

'Note 2' under the relevant amended provisions states that they are now civil penalty provisions, similarly 'Note 1' states that a failure to comply with the relevant subsection is an offence. Note 2 also points out that relief from liability to a civil penalty is available if proceedings that are eligible for the penalty are brought against the company or person and, having regard to all the circumstances, it appears to the court that the person has acted honestly.⁵⁰⁹

For contravention of ss674 or 675 under the corporation/scheme civil penalty provision, ASIC may apply to the Court for an order that a company, or a person, must pay a pecuniary penalty not exceeding \$200,000.⁵¹⁰ ASIC or the company can also apply for compensation if the corporation has suffered damages as a result of a person's failure to comply with continuous disclosure.⁵¹¹ Additional

⁵⁰⁸ CLERPA, note 59, formerly s1317DA.

⁵⁰⁹ Section 1317S.

⁵¹⁰ Section 1317J(1) enables ASIC to apply for an order for a person to pay to the Commonwealth a pecuniary penalty of up to \$200,000 (s1317G(1)). The penalty is a civil debt payable to ASIC on the Commonwealth's behalf (s1317G(2)).

⁵¹¹ Sections 1317J(1), (2) and 1317H(1).

subsections are inserted to provide similar pecuniary penalty orders and compensation orders for breach of a financial services civil penalty provision.⁵¹² As this group now encompasses financial products and services, access to compensation is extended to any ‘person who suffers damage in relation to a contravention’.⁵¹³

The advantage of including of s674 in the civil penalty regime is that the \$200,000 pecuniary penalty under s1317G(1) is considerably more than the \$22,000 pecuniary penalty for a continuous disclosure offence under Schedule 3, and yet it may be imposed following the lower, civil standard of proof, on a balance of probabilities.⁵¹⁴ The regulator anticipates that this extension of the civil penalty regime will overcome the fact that ‘there has not been a single criminal prosecution for a contravention of the continuous disclosure provisions since they were introduced in 1994’.⁵¹⁵

‘Due Diligence’ Defence

The earlier CASAC (1991) report⁵¹⁶ recommended that company directors should fulfil due diligence requirements to effect the necessary internal reporting mechanisms that would enable continuous disclosure to take place. In spite of this underlying policy, the CASAC (1996) report refrained from allowing a due diligence procedure to form a statutory defence to a contravention of s1001A/674.

Appendix 1 of CASAC (1996) contains recommendations for changes to the current continuous disclosure legislation. In particular, Recommendation 11 addresses a major criticism of the criminal sanction for breach of s1001A(3)/674(2) by stating that a statutory defence for listed disclosing entities is unnecessary if:

“the concepts of intention, recklessness and negligence are clarified, and a dishonesty requirement is included for criminal breach, namely that a person acted dishonestly and intending to gain, whether directly or indirectly, an advantage for that person

⁵¹² Financial Services Reform Bill 2001, note 21, Schedule 1 Financial Services and Markets Part 2 at 536 to 538 ss1317G(1A) and 1317HA; *Explanatory Memorandum*, note 11 at 15.4 to 15.6.

⁵¹³ *Ibid*, at s1317J(3A).

⁵¹⁴ Schedule 3 Penalties, note 19.

⁵¹⁵ Longo, note 32 at 41.

⁵¹⁶ CASAC (1991), note 2.

or any other person, or intended to deceive or defraud someone (for criminal liability ‘they acted dishonestly’ as per s1317FA(1)(b)).”⁵¹⁷

Persons should be liable for intentional breach of continuous disclosure requirements, either as principal or accessory, only if they ‘acted dishonestly’ and CASAC (1996) recommended that this phrase should be interpreted according to the terms of former s1317FA(1)(b).⁵¹⁸ It seems that if a company decides to rely on one of the ‘carve-outs’, as an exemption to the disclosure obligation, then the intention not to disclose would automatically be present. If the regulators do not support reliance on the ‘carve-out’ in a particular situation, then the principal or accessory could be placed in the vulnerable position of intending to breach the requirement.⁵¹⁹ Liability for negligent breach of the continuous disclosure requirement will only apply if insufficient care is taken concerning acts or omissions in relation to the public release of material information.⁵²⁰

Koek,⁵²¹ reflects the attitude of many directors and industry professionals concerning the absence of a statutory defence in light of ambiguity surrounding the tests used in determining the continuous disclosure obligation. Directors’ concerns arise from the uncertain application of these tests in a situation where criminal liability applies. Most of the issues in CASAC (1996) Recommendation 11, discussed above, are now incorporated in the *Criminal Code* as it applies to replacement s674 and their application must still be tested.

ASIC suggested that a provision similar to the former s1002G, relating to the relevant mental element in insider trading, could be introduced into s1001A/674.⁵²² Koeck argued for liability to only be attached to a specified list of matters that required disclosure. Alternatively, he recommended a

⁵¹⁷ CASAC (1996), note 26 at 41.

⁵¹⁸ Ibid, at 41 and Recommendation 11; CLERPA, note 59: s1317FA has been replaced, as criminal liability for a contravention of a civil penalty provision is now included after the primary provision, eg s184 when a director of a corporation commits an offence, or s209(3) when a person is involved dishonestly in a breach of s208 by providing a financial benefit to a related party without member approval.

⁵¹⁹ Ibid, at 41 and Recommendation 11.

⁵²⁰ Ibid, at 41-42 and Recommendation 11.

⁵²¹ Koeck, note 418 at 485.

⁵²² CASAC (1996), note 26 at 40-41.

statutory due diligence defence where a company has an established disclosure procedure.⁵²³ Such a procedure would trigger the presence of material price information that the company ought to disclose voluntarily. It was submitted that a statutory defence should be available for a company officer who decided on reasonable grounds, possibly in reliance on a ‘carve-out’ to listing rule 3.1, not to comply with continuous disclosure. CASAC, after discussions with its Legal Committee, declined to accept the above recommendations.⁵²⁴

In general terms, due diligence is now associated with avoidance of liability by corporate decision-makers:

“...evidence of due diligence, as a proxy for corporate integrity is increasingly used by the prosecutor as a threshold criterion for initiating a criminal investigation”.⁵²⁵

While a specific statutory due diligence defence is not available for a failure of continuous disclosure, it does exist for a failure to disclose information in a particular situation. If a failure to disclose is a misleading or deceptive ‘material omission’ from a prospectus, then the result can be a contravention of s728, the former s996. Such an omission, which is materially adverse from the point of view of an investor, is an offence under s728(3) and is associated with criminal liability under s1311 and Schedule 3.⁵²⁶ Those who have suffered loss or damage may take action for civil damages under s729 against directors of the company or persons named in the disclosure document.⁵²⁷

A due diligence defence against an offence under s728(3), or s729 civil liability action, is possible for such persons under s731(1), (2). The defendants must prove that they made all reasonable inquiries and believed on reasonable grounds that there was no misleading statement or omission. The defence could also apply to information supplied as part of the special prospectus content rules for continuously quoted securities (s713). There is an obligation to remedy any omission during the life of the prospectus by issuing a supplementary or replacement document (s719).⁵²⁸ This obligation to

⁵²³ Koeck, note 418 at 509.

⁵²⁴ CASAC (1996), note 26 at 41.

⁵²⁵ Laufer WS ‘Integrity, Diligence and the Limits of Good Corporate Citizenship’ (1996) 34 *American Business Law Journal* 157-181 at 163.

⁵²⁶ Schedule 3 Penalties, note 19.

⁵²⁷ CLERPA, note 59, formerly s1006.

⁵²⁸ Ibid, formerly s1023B.

provide relevant information would also exist under the continuous disclosure provision. This ‘due diligence’ procedure can act as an incentive for directors to supply investors and their professional advisers with ‘all the information’ that they would reasonably require for a special prospectus under s713(2).⁵²⁹

The application of a statutory due diligence defence is expanded with the introduction of the *Criminal Code*. The Code allows the defence if a company exercised due diligence to prevent ‘a high managerial agent of the body corporate’ from intentional, knowing or reckless failure to comply with the continuous disclosure provision.⁵³⁰

In many jurisdictions in the US, regulators will not proceed with prosecutions where a company has strong compliance programmes in place and there is evidence of due diligence procedures. Instead, regulators may grant leniency, an amnesty or immunity where there is a thorough due diligence procedure.⁵³¹

Two decisions of Courts in the US⁵³² show a need for directors to independently investigate the information given in a prospectus. The decisions indicate that the standard for ‘reasonable investigation’ will be higher for executive directors than for external directors.⁵³³ The same standard of due diligence would be expected to apply to the provision of any material information during the life of a prospectus.

Business Judgment Rule

Another statutory defence that has been excluded, in the event of a failure to disclose under s1001A/674, is the ‘business judgment rule’.⁵³⁴ The business judgment rule is a product of US

⁵²⁹ Ibid, formerly s1022AA(2)(b).

⁵³⁰ *Criminal Code* ss12.3(3) and (2)(b); the Code was discussed previously in this chapter under the heading Section 1001A/674 Liability.

⁵³¹ Laufer, note 525 at 164.

⁵³² *Escott v BarChris Construction Corporation*, note 281; *Feit v Leasco Data Processing Equipment Corp.* 332 F Supp 554 (1971) (USDC).

⁵³³ O’Byrne N and B Austin *Paper delivered at Business Law Education Centre Workshop on the New Companies Law* February 1991 reprinted in Redmond (1992), note 436, at 853, 856.

⁵³⁴ CLERPA, note 59: Section 180(2), the business judgment rule was introduced on 13 March 2000 as a defence to a breach of a director’s duty of care and diligence.

jurisprudence that provides, in certain situations, a corporate safe harbour for managers. Under the rule, if the company has decided on an action, then this decision will be respected if the directors are independent, act with due care and in good faith in the absence of self interest. The American Law Institute, in *ALI Principles of Corporate Governance* s4.01(c), states that the business judgment rule may apply when:

“...a director or officer who makes a business judgment in good faith fulfils the duty [of care]...if the director or officer:

- is not interested in the subject of the business judgment;
- is informed with respect to the subject of the business judgment to the extent that the director or officer reasonably believes to be appropriate under the circumstances; and
- rationally believes that the business judgment is in the best interests of the corporation”.⁵³⁵

This presumption will be rebutted if the decision cannot be attributed to a rational business purpose, or if the managers or directors have a personal financial interest in the decision. Otherwise it will be presumed that they ‘have acted independently, on an informed basis and in the good faith belief that the decision is in the best interests of the company’.⁵³⁶

If the business judgment rule is a defence based on the degree of care, skill and diligence involved in a decision-making process, then thorough due diligence procedures are required. Management will employ its business judgment to decide the timeliness of a disclosure or the genuine applicability of one of the ‘carve-outs’ to avoid or postpone disclosure to a less sensitive time.

A ‘business judgment’ defence for directors was one of the amendments included by CLERPA, effective from 13 March 2000. The business judgment rule offers directors a new ‘safe-harbour’ from personal liability for business decisions that are honest, informed and rational. The rule, as enacted in s180(2), only relates to decisions such as the ‘buying and selling of operational units’ of a company or determining fundraising methods. The safe harbour offered by the rule is not available for other civil breaches such as ‘insolvent trading and misleading statements in fundraising

⁵³⁵ Law L ‘The Business Judgment Rule in Australia: A Reappraisal since the AWA Case’ (1997) 15 *Company and Securities Law Journal* 174-188 at 176; Steinberg MI ‘The Corporate Law Reform Act 1992: A View from Abroad’ (1993) 3 *Australian Journal of Corporate Law* 154-177 at 163.

⁵³⁶ Steytler CD ‘Corporate Governance in Delaware’ (1997) 71 *Australian Law Journal* 90-91.

documents'.⁵³⁷ The defence does not operate in relation to duties under any other provision of the *Corporations Act*, or under any other laws.⁵³⁸

A note to s180(2), states that the defence will only operate in relation to a director's duty of care and diligence under s180(1) and the equivalent duty at common law or in equity. This includes a duty of care that arises in the tort of negligence. Although the future applicability to the continuous disclosure provision of this defence against civil liability cannot be totally dismissed, there is no suggestion at this time that the scope of the defence will be extended to include a director's decision to withhold material information from the market place.

Enforcement of Continuous Disclosure Regulation

'Responsive Regulation'

Ayers and Braithwaite, in their 1992 study on 'responsive regulation', initiated a debate concerning the need to transcend the intellectual stalemate between those who favour strong government regulation of business and those who advocate deregulation. This debate is appropriate to an:

“...era of regulatory flux - an era when dramatic regulatory, deregulatory and re-regulatory shifts are occurring simultaneously”.⁵³⁹

The authors suggest that the 'bigger and more various the sticks' available to enforce regulation, the greater the success regulators will achieve by speaking softly.⁵⁴⁰ The stronger the moral suasion, the more effective regulation will be. They argue that more regulation can be effected through moral persuasion if sanctions for non-compliance are kept in the background. Regulation of the securities industry is viewed through a general philosophical framework. The philosophy is less useful when the authors discuss a regime of 'enforced self-regulation' but their analysis of co-regulation, partial industry intervention and the enforcement pyramid structure of regulation is relevant.

⁵³⁷ Minter Ellison, note 327.

⁵³⁸ Corporate Law Economic Reform Bill 1998, Chapter 2D Division 1 s180(1), (2) and *Explanatory Memorandum* pars 6.1-6.10.

⁵³⁹ Ayers and Braithwaite, note 503 at 7.

⁵⁴⁰ *Ibid*, at 19.

Ayers and Braithwaite advocate a mix of private and public regulation. It is not necessary to choose between a *laissez-faire* market place and government regulation. Regulation needs to respond to industry conduct with a series of escalating forms of government intervention. These escalating forms will retain the benefits of *laissez-faire* governance without the regulator abdicating responsibility to correct market failure. They explain that:

“...for the responsive regulator, there are no optimal or best regulatory solutions, just solutions that respond better than others to the plural configuration of support and opposition that exist at a particular moment in history”.⁵⁴¹

Responsive regulation provides a guide in the form of an explicit enforcement pyramid. In most cases compliance is encouraged by means of persuasion, supported by escalating severity for non-compliance. At the pyramid’s pinnacle, a contravention incurs the harshest penalty. The six steps are, in ascending order of severity: persuasion, a warning letter, imposition of a civil penalty, criminal liability, suspension of the relevant licence and finally revocation of the licence.⁵⁴² However, for these steps to prove an effective deterrent, ‘the threat of escalation to serious levels of regulatory response must be credible’.⁵⁴³

The greatest proportion of enforcement activity occurs at the base of the pyramid, with the pinnacle representing the regulator’s ‘benign big gun’, which is the strongest but least used sanction. In corporate compliance, the steps of an escalating enforcement regime could be the six steps suggested by Ayers and Braithwaite or the simpler four step compliance model developed for the Australian Tax Office.⁵⁴⁴ These regulatory strategies of the tax office initially assume that all taxpayers are honest. The first step is self-regulation of the taxpayer, which leads to a second step of enforced self-regulation. The hierarchy of sanctions escalates to a third step, discretionary command regulation, and if necessary to a fourth step, which is non-discretionary command regulation.

⁵⁴¹ Ibid, at 5.

⁵⁴² Ibid, at 35, 36.

⁵⁴³ Dellitt C and B Fisse ‘Civil and Criminal Liability under Australian Securities Regulation: The Possibility of Strategic Enforcement’ 570-617 at 580 in G Walker and B Fisse eds *Securities Regulation in Australia and New Zealand* Auckland OUP 1994.

⁵⁴⁴ Coleman C and L Freeman ‘Changing Attitudes of Small Business Owners to the ATO in a Tax Reform Environment’ University of Sydney Accounting Foundation *Research Seminar Series* 21 April 1999 at 12, 20.

With the advent of civil penalties, continuous disclosure regulation manifests all the recommended steps of the enforcement pyramid. The order of the steps could differ if the action by the regulator is taken against an individual rather than a company. The position of steps 5 and 6 of the Ayers and Braithwaite model could be subject to debate in an Australian context. Prior to the insertion of s1001A/674 into the *Corporations Act*, ASX's response to a non-compliant company was suspension of trading in the company's securities, the equivalent of step 5, or removal of the company from the Official List, the equivalent of step 6. From ASX's point of view these would have been the most likely actions taken after steps 1 and 2, the failure of both persuasion and a warning letter.

In the event of continued non-compliance, ASX could delist the company or make application to the Court for an order to enforce listing rule 3.1 under ss777/793C and 1114/1101B. However, prior to the protection now offered by qualified privilege under s779/1100B, and an exemption to a guarantee of damages, ASX was unlikely to take such action. The section on *ASX Enforcement*, later in this chapter, discusses these issues.

As a result of the amendments of 5 September 1994, the hierarchy and range of penalties offered by the enforcement pyramid is partially restored. At its pinnacle is the harshest penalty, ASIC's ability to initiate a criminal prosecution for non-disclosure against a listed company (s1001A(3)/674(2)), or an individual, if there is an intentional or reckless contravention. This provides an alternative to penalising all shareholders with a long-term suspension of securities or final removal of the company from the Official List. ASX can still utilise a short-term suspension of trading if there is an unsatisfactory response to a warning letter or query.

The enforcement pyramid illustrates a range of sanctions for degrees of *mens rea*, scaled from ignorance to intent. Flexibility of enforcement can accommodate the seriousness of the effect on the market place of a particular non-disclosure. Information is withheld from the market either by negligence or intent. Most economic models assume that a company has weighed the cost and benefit of compliance with the law before deciding not to comply, but this is not always the case. Although ignorance of the law is no defence, it can indicate a lesser sanction in a situation where directors of a company rely on 'carve-outs' in listing rule 3.1 and:

“...they might know what the law is, but fail to grasp the fact that it applies in particular circumstances, or lose sight of this fact.”⁵⁴⁵

⁵⁴⁵ Ayers and Braithwaite, note 503 at 80.

The Ayers and Braithwaite concept of ‘enforced self-regulation’⁵⁴⁶ aims to overcome the generality of provisions, such as s1001A/674 and listing rule 3.1, that apply to all listed companies. The main benefits of self-regulation are cost savings to the regulator in inspection overheads and the notion that regulation becomes more palatable if it is self-imposed. Each company would be required to write its own set of rules, tailored to that company’s unique circumstances. The regulator would then either approve these rules or return them for revision if they were considered unsuitable. Enforcement of the rules would be the responsibility of an independent compliance committee within each company. Although total enforced self-regulation of listed companies is hardly practical, given the volume of legislation and rules already in place, there are limited aspects of the concept already present in the Australian securities industry.

Aspects of enforced self-regulation are apparent in Chapter 4 of the *ASX Listing Rules*. To a certain extent a listed company can write its own rules on matters of corporate governance. For example, listing rule 4.10.2 does not prescribe that a company must have an audit committee but, if there is no such committee, the company must explain why it has not formed one. A listed company is asked to provide a statement of its main corporate governance practices (rule 4.10.3) and an indicative list of these is provided as an Attachment to Guidance Note 9. As an example, if a listed company has formed a nomination committee or a remuneration committee, then ASX requests, but does not demand, this disclosure.

ASIC Enforcement Powers

ASIC supports the concept of an enforcement pyramid. In a review of the existing penalties for breach of the continuous disclosure provision, ASIC submitted that it would be useful to have a wider range of enforcement options. Recommendation 12 of the CASAC (1996) report suggested that ASIC should have the power to impose a small administrative penalty of approximately \$5,000 for a minor contravention without application to the court.⁵⁴⁷ This would offer an alternative to civil or criminal penalties.

⁵⁴⁶ Ibid, at 106.

⁵⁴⁷ CASAC (1996), note 26 at 42, 43.

ASIC continues to call for the flexibility to impose fines for market offences without reference to the Courts, similar to those granted to the Financial Services Authority in the UK.⁵⁴⁸ Recently, the Commission took no action against a leading mining company for breach of the continuous disclosure rules. This inaction occurred in spite of advice from senior counsel that there was an arguable case. The decision not to proceed was weighted by ‘considerable doubt that any effective remedy is available to ASIC under the Corporations Act’.⁵⁴⁹ As the Chairman of ASIC stated:

“This case further highlights the need to review the sanctions available to the ASX and ASIC to underpin disclosure.”⁵⁵⁰

CASAC (1996) also recommended that ASIC should have the power to demand enforceable undertakings regarding an information processing system, or any other remedial action, to be implemented by a disclosing entity. ASIC argued that this wider range of enforcement options, rather than reliance on civil or criminal litigation, would encourage compliance with continuous disclosure.⁵⁵¹ ASIC has increased its armoury of penalties with the introduction, and publication, of those companies subject to enforceable undertakings.

This particular type of ‘enforced self regulation’ is in keeping with the principles of Ayers and Braithwaite’s enforcement pyramid. Section 93AA of the ASIC Act introduced a provision for enforceable undertakings by companies from 1 July 1998. Under the provision, the Commission may accept a written undertaking from a person in connection with any matter that is within ASIC’s function or power. There is no set period of enforcement and the undertaking can be varied or withdrawn at any time with ASIC’s permission.

If the undertaking is breached, ASIC can seek a court order enforcing compliance of the undertaking, or any other appropriate order. ASIC regards an enforceable undertaking as a flexible and timely regulatory alternative to civil or administrative proceedings by the Commission. However, an undertaking will not be accepted by ASIC as an alternative to criminal liability.⁵⁵²

⁵⁴⁸ *ASIC Media Release* 01/283 13 August 2001; Knott, note 270 at 3, 4. See also section on *United Kingdom* in Chapter 4.

⁵⁴⁹ *ASIC Media Release* ‘ASIC Concludes Investigation into WMC Ltd’ 02/79 7 March 2002 at 1.

⁵⁵⁰ *Ibid.*

⁵⁵¹ CASAC (1996), note 26 at 42, 43.

⁵⁵² Statement by ASIC Commissioner Jillian Segal in *ASIC Media Release* 98/343 12 November 1998; *ASIC Practice Notes* PN69 7 April 1999 Part A.

ASIC elicits a certain degree of peer pressure to enforce the undertaking by exposing the relevant person, or company, to the rigour of detailing the undertaking on a public register. One of the initial undertakings was accepted from Crown Casino in response to evidence of the company's inadequate continuous disclosure policy in early 1998. Crown Casino agreed to 'report quarterly to the market and establish an internal compliance plan and manual'.⁵⁵³ Enforceable undertakings provide a quicker and cheaper remedy than court proceedings and in the initial period, from November 1998 to June 1999, ASIC obtained 25 undertakings from companies concerning disclosure, financial reporting and compliance.⁵⁵⁴ In the 2000-2001 year, this has increased to 46 enforceable undertakings involving 'lesser alleged breaches'.⁵⁵⁵

The publication of these undertakings is a key element in the successful enforcement of the agreements. Public awareness of the undertaking by peer companies and investors should stimulate compliance by the delinquent company. Some directors have suggested that public exposure of a company's standard of compliance could be used to assist enforcement of continuous disclosure. Professional bodies could publish a 'score card', similar to the disclosure ratings in the *Annual Report Awards*, of those companies that provide the best continuous disclosure and those that fail to release material information in a timely manner. Directors have also suggested that an independent commercial panel could be more effective than the existing regulators in enforcement and arbitration of continuous disclosure issues.⁵⁵⁶

Section 50 of the ASIC Act

In many instances of suspected non-disclosure by a listed company, ASX will not directly enforce listing rule 3.1 but will forward the complaint to ASIC. The Commission has the power under the ASIC Act and the *Corporations Act* to investigate and take action against a company and its officers. Should the situation arise, it is now clear that ASIC has authority, with the person's or company's written consent, to cause 'such a proceeding to be begun and carried on in the person's name'.⁵⁵⁷

⁵⁵³ *ASIC Media Release 98/277* 11 September 1998 and *98/343* 12 November 1998 concerning Crown Limited.

⁵⁵⁴ Australian Securities and Investments Commission *ASIC Annual Report 1998-99* at 12.

⁵⁵⁵ Australian Securities and Investments Commission *ASIC Annual Report 2000-2001* at 27.

⁵⁵⁶ Corlett, note 48 at 117, 154.

⁵⁵⁷ ASIC Act s50(d).

ASIC has the discretionary power under the s50(a) of the ASIC Act to take a derivative civil action for fraud, negligence, breach of duty or other misconduct connected with an investigation. If it is in the public interest, the Commission can cause these proceedings to be carried out in the name of the company. In such a situation, there was some doubt as to whether ASIC was bound by the rule in *Foss v Harbottle*.⁵⁵⁸ The rule states that the company is the proper plaintiff to bring an action against its directors or officers in relation to a wrong done to the company.⁵⁵⁹

Lindgren J, in *Australian Securities Commission v Deloitte Touche Tohmatsu*⁵⁶⁰ at first instance, maintained that ASIC had failed to properly take into consideration the rule in *Foss v Harbottle* when interpreting its powers under s50. An appeal by the Commission, to Beaumont, Drummond and Sundberg JJ of the Federal Court, was upheld. The Court held that the phrase ‘it appears to the Commission’ in s50 was intended to confer on ASIC an extremely wide discretion. Also, the ‘public interest’ requirement in s50 is in accord with the Commission’s functions and powers under s1(2) of the ASIC Act. The wide aims of the legislation support a value judgment by ASIC and it is not bound to take the *Foss v Harbottle* factor into account when reaching a decision.

The Corporate Law Economic Reform Program Bill 1998 introduced a statutory derivative action that removed the need to consider the exemptions of *Foss v Harbottle*. Under s236(3), the right of a person at general law to bring, or intervene in, proceedings on behalf of a company is abolished. ASIC is excluded as an eligible applicant from the s236(1) list of those persons who, with leave of the Court under s237(1), may proceed with a derivative action.

The *Explanatory Memorandum* to the Bill states that there is not proper role for ASIC to bring proceedings under s236 as ‘the basic policy objective of derivative proceedings is to provide an effective remedy for investors and to overcome the difficulties in *Foss v Harbottle*’.⁵⁶¹ The statutory derivative action removes some of the regulatory burden from ASIC as it makes it easier for private parties to enforce their existing rights and protect the interest of the company.⁵⁶²

⁵⁵⁸ *Foss v Harbottle* (1843) Hare 461; 67 ER 189.

⁵⁵⁹ Ford *et al*, note 323 at 575.

⁵⁶⁰ *Australian Securities Commission v Deloitte Touche Tohmatsu* (1996) 21 ACSR 332.

⁵⁶¹ Corporate Law Economic Reform Program Bill 1998 *Explanatory Memorandum* par 6.30.

⁵⁶² *Ibid*.

The *Explanatory Memorandum* points out that there are other means by which ASIC may commence actions on behalf of investors, namely s50 of the ASIC Act. The Commission can also intervene and be deemed to be party to proceedings relating to a matter arising under the *Corporations Act* under s1330(1) and (2). However, ASIC policy is that it will review all requests for intervention on a case by case basis and usually will only consider intervention when it is a matter of national significance, is concerned with a construction of the *Corporations Act*, or it has information acquired through an investigation that is relevant to the determination of the issue before the Court.⁵⁶³ Also, for the protection of minorities, ASIC will ‘seek to intervene and exercise its powers pursuant to s50’ of the ASIC Act.⁵⁶⁴

ASX Enforcement

The statutory enforcement offered for the listing rules, and particularly rule 3.1, is designed to support the role of the stock exchange. Theoretically, ASX, as did its predecessors, writes the listing rules that govern those companies whose securities are traded on the stock market. However, under s774(5)/793E(3), (4) the Minister may disallow amendments to the rules if they will not ensure that the market is ‘a fair, orderly and transparent market’ (s769A(1)/792A(a)). For some time, this independence of the stock exchange has in reality been one of co-regulation and close cooperation with ASIC. Much closer regulation exists since the insertion of s772B/798C, which allows ASX to be included on its own Official List.

ASX became a listed company in October 1998 and is directly supervised by ASIC with respect to compliance with ASX listing rules.⁵⁶⁵ This was followed by the formation of ASX Supervisory Review Pty Ltd (ASXSR), which was operational from March 2001 to provide surveillance of the regulatory functions of ASX.⁵⁶⁶ The new subsidiary does not administer the day to day regulatory duties of ASX but is designed to create a third party independent supervisor between the stock

⁵⁶³ *ASIC Policy Statements* ‘Intervention’ PS4 issued 3 June 1991 pars 4.1, 4.3(a), (b), (c).

⁵⁶⁴ *Ibid*, par 4.3(d).

⁵⁶⁵ ASX was demutualised on Tuesday 13 October 1998 and its securities were listed for trading on its own stock market from the following day. *ASIC Media Release* 98/292 23 September 1998; ASX website.

⁵⁶⁶ *ASIC Media Release* ‘ASIC Welcomes New Oversight Responsibilities for Market Operators’ 00/466 9 November 2000; *ASX Media Release* ‘ASX’s Supervisory Arrangements’ - Richard Humphry, Managing Director ASX, released details of the establishment of ASX Supervisory Review Pty Ltd at a Securities Institute Corporate Briefing, 9 November 2000.

exchange's dual role as regulator and listed company. Its specific task is to oversee 'decision-making in respect of entities with which ASX has a conflict of interest – essentially commercial partners or competitors'.⁵⁶⁷

The Senate Economic References Committee also recognises the potential conflicts between ASX's commercial and supervisory responsibilities but in its recent report it considered that:

“...ASX should be given a period of time to demonstrate that initiatives such as ASXSR are sufficient to address the conflicts of interests issues.”⁵⁶⁸

ASIC is to audit ASX compliance with its supervisory obligations to ensure that ASXSR has appropriate resources and reporting structures.⁵⁶⁹

The stock exchange has a positive duty to provide all reasonable assistance to ASIC in the performance of its duties.⁵⁷⁰ Concurrent with the introduction of the continuous disclosure provision, ASX's co-regulatory responsibilities with ASIC were amended by the insertion of s776(2A), (2B)/792B. These provisions apply if the stock exchange believes that a person has committed, or is about to commit, a serious contravention of a listing rule or the *Corporations Act*. In this event, it must as soon as practicable lodge with ASIC a statement of the particulars of the contravention.

In the past, ASX could be deterred from taking action to enforce its listing rules. There was a latent concern that a disaffected company could sue for defamation if ASX published information that was later found to be incorrect. Also, ASX could be liable for damages if court action against a company was unsuccessful.⁵⁷¹ Although it failed to support qualified privilege for the stock exchange, the Standing Committee on Legal and Constitutional Affairs recommended in 1991 that the *Corporations Act* should be amended to give ASX the right to institute proceedings under ss777/793C and 1114/1101B without having to give an undertaking as to damages.⁵⁷²

⁵⁶⁷ Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 31.

⁵⁶⁸ Parliament of Australia, Senate Economics References Committee *Inquiry into the Framework for the Market Supervision of Australia's Stock Exchanges* 11 February 2002 Executive Summary and Findings at xvii.

⁵⁶⁹ Ibid.

⁵⁷⁰ Section 776(1)/792D.

⁵⁷¹ Lavarch Report, note 1 pars 2.5.12-13.

⁵⁷² Ibid, Recommendation 3 par 2.5.33.

However, the Committee's recommendations were opposed to ASX having the protection of qualified privilege against an action for defamation. The evaluation of the Committee, at that stage, was that ASX would enforce the listing rules only where there were reasonable grounds to do so. Alternatively, an ASX decision to make statements to the market concerning the activities of listed companies would be based on reasonable grounds.⁵⁷³ Evidence of 'reasonable grounds' should be considered sufficient protection against legal action.

By 1994, the Corporate Law Reform Bill proposed that:

“ASX should not have to give an undertaking as to damages when seeking a Court order in relation to a breach of its Rules. In addition, the protection of qualified privilege will be expressly conferred on securities exchanges, including ASX, where they publish information provided to them under a disclosure regime (whether legislative or pursuant to their rules).”⁵⁷⁴

The existing s779/1100B already granted limited qualified privilege to the stock exchange in respect of any disciplinary proceedings it might take under the business rules against a member of ASX. With the introduction of ED on 5 September 1994, the former s779 was amended. The insertion of s779(5)-(10) accorded qualified privilege to ASX for the publication of information given to the stock exchange under its rules or under the legislation. In addition to mandatory periodic disclosure, the privilege applies to any continuous disclosure released under listing rule 3.1 and s1001A/674.

ASX would also be protected by replacement s1100B qualified privilege when it queries a listed company. The 427 query notices analysed in Chapter 3 of this study would have been the subject of the former s779(7) privilege. This provision stated that:

“A securities exchange has qualified privilege in respect of the publication of:

- (a) information about a request by the exchange to a listed entity for information in relation to compliance by the entity with, or a contravention by the entity of, this Law or the exchange's rules; or
- (b) information, or a document, given to the exchange by a listed entity in response to such a request.”

⁵⁷³ Ibid, Recommendation 1 pars 2.5.26-27.

⁵⁷⁴ Corporate Law Reform Bill 1994, note 70 at par 23 (item 109 and 91 of Schedule 1).

Summary

In this chapter, the legal environment, and some recent reforms, have been considered with relation to continuous disclosure and insider trading. The enforcement of disclosure regulation was discussed, with particular attention to the powers of ASIC and ASX.

These powers are in accord with the Ayers and Braithwaite argument that the availability of tough enforcement measures at the apex of the regulatory pyramid will ensure that a regulator will seldom need to rely on this maximum penalty. The assumption supporting this argument is that there is a gradually ascending array of penalties, which are available and utilised, to lend credibility to the maximum penalty. These penalties have been discussed throughout the chapter.

The following Chapter 6 will trace implications, drawn from the statistical results in the Chapter 3 empirical study, for the regulatory procedures of ASIC and ASX as discussed in Chapter 5.

CHAPTER 6

Legal Implications of the Empirical Analysis of ASX Queries

The conclusions drawn from the results of the empirical analysis outlined in Chapter 3 can be related to the legal issues under the following headings:

- The Regulatory Choice
- The Link between Continuous Disclosure and Insider Trading
- Utilising the Regulatory Tools
- ASIC and ASX Policy Developments

The Regulatory Choice

Stock markets can operate without continuous disclosure regulation. It can be left to market forces to encourage voluntary disclosure or expose latent material information to complement mandatory periodic reporting. In keeping with the Efficient Market Theory, as discussed at the beginning of Chapter 3, the existence of undisclosed material information can be transmitted to the market by insider trading.

It was the choice of the legislators, representing the aspirations of society for a 'fairer market place', to prescribe statutory continuous disclosure to support the existing listing requirement. This choice, once made, needs to be validated by successful implementation. By necessity, this implementation will always rest on a trade off between the cost of enforcing the regulation and its advantage to the market.

Regulatory Balance

ASX states that it has two prime objectives:

- providing a fair and well informed market for financial securities; and
- providing an internationally competitive market.⁵⁷⁵

The stock exchange considers its continuous disclosure regime to be a timely and pragmatic means of achieving a well informed market. The regime considers the benefits to investors, the commensurate costs to listed companies and it is also mindful of the administrative and enforcement costs that accrue to the regulators. ASX has the stated policy that when considering whether the conditions of

⁵⁷⁵ *ASX Listing Rules* Introduction 30 September 2001.

listing rule 3.1 are satisfied, it will consider the needs of the market and the interests of the entity, while ‘bearing in mind the principle on which the listing rule is based’.⁵⁷⁶

The listing rules are drawn from a number of underlying principles designed to balance the interests of the listed companies, the protection of investors and the reputation of the market place. The relevant principle, on which listing rule 3.1 is based, encapsulates the regulatory demands of the continuous disclosure provision. It states that there must be timely disclosure of information that may affect the value of securities or influence investment decisions.⁵⁷⁷ In turn, these listing rules are an essential element in achieving ASX’s objectives as stated above.

Because of the need to balance value to the market and cost to the company, ASX does not wish to be overwhelmed with the minutiae of voluminous company announcements. ASX points out that the ‘reasonable person’ test, contained in listing rule 3.1.1, and discussed in Chapter 5, implies that a company is exempt from compliance if a reasonable person would not expect the information to be disclosed. However, a company is also exempt if a reasonable person would not expect disclosure of an inordinate amount of detail.⁵⁷⁸

Those companies that prematurely attest that the market is ‘fully informed’ would be likely to support this exemption.⁵⁷⁹ Evidence of more positive action being taken by ASX in enforcing continuous disclosure, is the removal of the reference to an ‘inordinate amount of detail’ from the current revised guidance note.⁵⁸⁰

In spite of ASX’s resistance to the volume of disclosure, it is evident from the study by Brown *et al*⁵⁸¹ that since the implementation of the ED regime, the total number of disclosures made to ASX by listed companies has increased by approximately 30 per cent. With a greater number of listed

⁵⁷⁶ *ASX Listing Rules* Guidance Note on Continuous Disclosure par 19 issued 1 July 1996, replaced by Guidance Note 8 par 22 issued September 2001.

⁵⁷⁷ ASX lists ten underlying principles in the Introduction to the *ASX Listing Rules*. The principle stating timely disclosure by listed companies ranks as number five.

⁵⁷⁸ *ASX Listing Rules* Guidance Note on Continuous Disclosure par 18 issued 1 July 1996, replaced by Guidance Note 8 par 17 issued 16 November 1998.

⁵⁷⁹ Table 12.

⁵⁸⁰ *ASX Listing Rules* Guidance Note 8 on Continuous Disclosure par 22 issued September 2001.

⁵⁸¹ CASAC (1996), note 26 at Appendix 8 at 21, Table 1 Panel B.

companies and a more active market this figure is now likely to be much higher. The increase in quantity, much of it in the form of periodic reporting, does not necessarily support the premise that the statutory sanctions of s1001A/674 have significantly affected corporate disclosure policies or the timeliness of disclosure.⁵⁸²

The complexity of regulatory oversight by ASX and ASIC increases as more companies obtain additional listings on international exchanges. This situation adds a disparity of disclosure standards in differing time zones. Harmonisation of regulation is also a major concern as ASX contemplates closer alliances with these stock exchanges.⁵⁸³ If global electronic trading becomes the norm, there will be associated monitoring and regulatory difficulties. There is some concern that the rising cost of regulation, and a demand for more flexible rules to accommodate globalisation, will result in a 'race to the bottom' – a situation where standards of corporate behaviour will diminish as companies search for less onerous market regulation.⁵⁸⁴

ASX states that a policy of constant watchfulness will maintain market integrity,⁵⁸⁵ but costly⁵⁸⁶ market surveillance mechanisms alone are not sufficient to ensure a fully informed market. The stock exchange considers that one of its main advantages, in fulfilling its other stated objective⁵⁸⁷ of providing an internationally competitive market place, is 'the reality and the perception' of its

⁵⁸² Brown P, SL Taylor and TS Walter 'The Impact of Statutory Sanctions on the Level and Information Content of Voluntary Corporate Disclosure' (1999) 35 *Abacus* 138-162 at 141.

⁵⁸³ ASX World Link includes the US link, which from March 2001 provides a trading link to access securities on US markets, and a reciprocal trading link with the Singapore market from 20 December 2001: Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 10, 24; 'ASX-SGX Link to Go Live' *ASX Media Release* 13 December 2001.

⁵⁸⁴ Goldwasser VR 'Current Issues in the Internationalisation of Securities Markets' (1998) 16 *Company and Securities Law Journal* 464-485 at 479.

⁵⁸⁵ Australian Stock Exchange Limited *Annual Report 1999* 'The Year in Review'.

⁵⁸⁶ *Ibid*, ASX notes in its 1999 annual report that it devoted more than \$10 million of its operating expenses to its role of monitoring trading activity for irregularities and ensuring corporate compliance with the ASX listing rules. Funding of ASX Supervisory Review Pty Ltd, which is operational from March 2001, will cost approximately \$1 million. Sources: 'ASX's Supervisory Arrangements' *ASX Media Release* 9 November 2000; Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 31.

⁵⁸⁷ *ASX Listing Rules* Introduction 30 September 2001.

integrity. In contrast, investors will impose a ‘risk premium’ on securities that are issued or traded in markets with lower regulatory standards.⁵⁸⁸

The Link between Continuous Disclosure and Insider Trading

There is no definitive study that exposes the extent of insider trading and the degree to which this is linked to a failure of timely corporate disclosure. However, the empirical study in Chapter 3 strongly indicates that, in many situations, there could be a specific connection between non-public information and selective trading activity.

The connection between a failure to disclose material information and insider trading was recognised as ‘prohibited conduct’ with the proximity of the former s1001A to s1002G. The focus is redirected in the amended legislation, if not in practice, by the repositioning of continuous disclosure in a separate Chapter 6CA prior to prospectus disclosure. It is anticipated that compensation for this amendment will be greater emphasis on the disclosure obligation. This may come at the expense of the implicit warning that could be conveyed when continuous disclosure was associated with other forms of ‘prohibited conduct’ in Chapter 7 of the *Corporations Act*.

The following instances of apparent inadequate disclosure were highlighted in Chapter 3 and they illustrate the link with insider trading. In each case, a component of listing rule 3.1, an example, a guidance note item or ‘carve out’, appears to be overlooked or ignored. The resultant uninformed market and selective trading is of concern to ASX.

Listing Rule 3.1 ‘Example’ of a Disclosure Situation

Share price movement in anticipation of the release of a company’s financial report is a common occurrence. If the financial results are contrary to prior forecasts, then earlier disclosure could be required. In one example,⁵⁸⁹ an ASX query was made shortly before the release of the company’s preliminary final announcement, which subsequently reported an unexpected profit instead of the prospectus forecast of a loss. The query concerned unexplained price increases occurring over several weeks prior to the release of the preliminary final report.

⁵⁸⁸ Lawrence J ‘The Economics of Market Confidence: (Ac)Costing Securities Market Regulations’ (2000) 18 *Company and Securities Law Journal* 171-196 at 183.

⁵⁸⁹ See section on ASX’s second trading induced query to *Digicall Group Limited* in Chapter 3. Other Digicall queries are discussed in *Analyst Reports and Broker Recommendations*, a later section of this chapter.

The company failed to observe that directly below listing rule 3.1, ASX includes a number of examples of the type of price sensitive information that is material under the continuous disclosure rule. The first of the examples, all of which are in extremely small print that belie their importance, concerns ‘a change in the entity’s financial forecast or expectation’.

It is evident from the empirical study for this thesis that the importance of the continuous disclosure rule must be constantly reinforced to bring it to the attention of those responsible for disclosure. Ease of perusal, of the examples of material information and the proximity of the guidance note to listing rule 3.1, should be fundamental as a means of increasing the visibility of the continuous disclosure obligation.

Market Speculation as a Disclosure Situation

ASX does not expect an entity to respond to all comments or market speculation made by the media. However, when the comment or speculation becomes reasonably specific, and appears to result in share price movement, ASX will ‘call on’ or ‘usually require a statement’⁵⁹⁰ if one has not already been forthcoming from the company. In this instance, ASX policy is outlined in the paragraph of the guidance note concerning market speculation. This wording of paragraph 30 of the guidance note could relieve the company of the responsibility to respond to market speculation until ASX has initiated a query and called on the company to ensure the market is fully informed.

Often the replies from the company⁵⁹¹ are within the specific parameters of paragraph 30 but, in general, the onus to respond should be placed more strongly on the company, particularly where abnormal share price movement accompanies speculation. As discussed in Chapter 3, it is not incumbent on directors of a listed company to pre-empt an announcement of another company. This relates to market trading in the securities of Mt Kersey Mining NL, resulting from the nickel discovery at Silver Swan. In this instance, the legal non-disclosure by an unlisted company prompted

⁵⁹⁰ *ASX Listing Rules* Guidance Note on Continuous Disclosure par 30 issued 16 November 1998, replaced by revised wording in Guidance Note 8 par 37 issued September 2001.

⁵⁹¹ See sections on *Abador Gold NL Query 2* and *Mt Kersey Mining NL* in Chapter 3. Abador replied promptly to a trading induced ASX query that it had a mining project only a few kilometres from the recently announced nickel discovery by Mining Project Investors Pty Ltd. Two months later, ASX again queried fluctuations in the price of Abador’s securities. Abador stated that there was no material information to disclose but suggested that there had been recent press and market interest in companies that were in close proximity to the Silver Swan nickel discovery.

the potentially illegal insider trading in a listed company, which was the subject of an unsuccessful prosecution in 1999.⁵⁹²

Reliance on 'Carve-Outs'

The third example of a trading induced query⁵⁹³ raises a specific point of market speculation in the context of reliance on a 'carve-out'. This is a situation common to almost 30 per cent of the companies in the sample.⁵⁹⁴ Since it lodged its quarterly report, the company has obtained recently processed data concerning one relevant exploration site. As these results are still being assessed, the company probably relies on 'carve-out' 3.1.3(c) that the information 'is insufficiently definite to warrant disclosure'.

Frequently, such a reply to the ASX query concludes with the standard confirmation that the market is fully informed and the company is complying with the listing rules of ASX.⁵⁹⁵ The company's reply points to a common inconsistency raised by listing rule 3.1. This occurs when a company is relying on one of the 'carve-outs', and argues that it is complying with its continuous disclosure obligations. There is inconsistency between the company's stance and the market reaction.

In another example,⁵⁹⁶ abnormal price fluctuations continue in spite of three trading induced queries from ASX. Almost a month after the initial query the company made full disclosure to ASX. The company possibly considered that it had made legitimate use of the 'carve-out' in listing rule 3.1.3(b) as the information concerned an 'incomplete proposal or negotiation'. However, for the 'carve-out' to be an effective defence against an accusation of non-disclosure, the information must remain confidential under listing rule 3.1.2.

Information confidentiality is doubtful when continued share price variation prompts repeated ASX queries. In situations such as this, there is a lack of rigour in ASX's query format. The company is

⁵⁹² See section on *Insider Trading Case Law* in Chapter 5.

⁵⁹³ See section on *Abador Gold NL Query 3* in Chapter 3.

⁵⁹⁴ Table 12, 120 Total Queries in the Incomplete Proposal and the Qualified Fully Informed categories.

⁵⁹⁵ Australian Stock Exchange and Abador Gold NL correspondence 7 February 1996.

⁵⁹⁶ See sections on *Goldsearch NL* in Chapter 3.

not required to submit evidence that it is relying on a ‘carve-out’ or any evidence in support of its assertion that there are no matters of importance to disclose.

In some instances, directors fail to correctly evaluate the importance, or materiality, of the information. The directors are not consciously relying on a ‘carve-out’, as this would require an acknowledgement that the information is material, they just fail to appreciate its relevance to the market. However, as in the above example, continued buying pressure and abnormal price and volume movements in the trading of a company’s securities should provide sufficient indication of the potential materiality of the undisclosed information.

As noted in Chapter 5,⁵⁹⁷ information is material when there is a substantial likelihood that a reasonable investor would consider that the additional information would significantly alter the ‘total mix’ of existing information. If directors are genuinely uncertain as to the material relevance of information to the company, then ASX officers are available to advise on whether disclosure to the market is required immediately, whether it is unnecessary or should merely be postponed until more complete information is available.

ASX states that it does not seek, under listing rule 3.1.3 (b), (d) and (e), to compel a company to disclose incomplete negotiations, internal management information or trade secrets. However, it clearly states in the guidance note:

“...it is ASX policy that, whatever the information, and however much it might otherwise have been reasonable not to disclose it, the information should be released to the whole market once it becomes known to any part of the market”.⁵⁹⁸

The difficulty with this wording is that the company has been able to rely on the excuse that it has no evidence that the confidential information of the ‘carve-out’ has become known to a segment of the market. There is nothing in this paragraph of the guidance note to link the company’s responsibility for continuous disclosure with an unknown, but suspected, leak to part of the market as exhibited by abnormal price or volume movement. The issue of unusual activity in a company’s securities, which

⁵⁹⁷ Marshall J in *TSC Industries Inc v Northway Inc*, note 419. See section on *Degree of Materiality* in Chapter 5.

⁵⁹⁸ *ASX Listing Rules* Guidance Note on Continuous Disclosure par 31 issued 1 July 1996.

could suggest the information is no longer confidential, is dealt with in an earlier paragraph of the guidance note concerning listing rule 3.1.2.⁵⁹⁹

This situation is partially remedied by the inclusion of paragraph 39 in the current guidance note that encourages entities ‘to develop procedures for responding to rumours and speculation in the media and other forums’.⁶⁰⁰ Readers are then referred to ASX’s commentary on ASIC’s guidance principles that are included from paragraph 55.

Substantial Shareholder Notification

A number of companies in the sample were disadvantaged when replying to ASX queries regarding exceptional price fluctuations and large block trades.⁶⁰¹ From market observation, the company can acknowledge the trading volume but still be unable, under the substantial shareholder provisions of the *Corporations Act*, to identify the vendor or purchaser of the securities.

In this example, there is a discrepancy between ASX’s ideal of ‘immediate’ disclosure of material information, and the reality of substantial shareholder trading. Under listing rule 4.10.4, ASX only requires disclosure of the names of substantial shareholders to be included as additional information in a company’s annual report. It is s671B(1) of the *Corporations Act* that provides guidelines for disclosure of a change in shareholding. A person who has a substantial shareholding⁶⁰² of five per cent or more in a listed company must disclose it to the company concerned and ASX when there is an alteration of at least one per cent in this holding (s671B(1)(b), (2)). The deadline for the substantial shareholder to provide this information is within two business days of the holder becoming aware of the purchase or sale of the shares (s671B(6)).

This provision allows sufficient time for a broker to notify the client of the completion of the transaction, the client must then notify the company in which it has the substantial shareholding and the stock exchange. The provision is hardly time sensitive and conflicts with the policy of immediate

⁵⁹⁹ Ibid, par 22.

⁶⁰⁰ *ASX Listing Rules* Guidance Note 8 on Continuous Disclosure pars 37-39, 25-28 issued September 2001. Guidance Note 8 includes the incorrectly titled ‘Better disclosure to investors – ASIC Guidance Principles’.

⁶⁰¹ See sections on *Goldsearch NL* in Chapter 3.

⁶⁰² “‘Substantial holding’...is 5% or more of the total number of votes attached to voting shares in the body...’ s9 *Corporations Act*.

disclosure, particularly where trading in the stock continues to be volatile. If it is difficult to reduce the two day notification period provided by the statute, then transparency could be improved by full public disclosure of the ASX query when it is issued to the company.

Utilising the Regulatory Tools

There is now sufficient disclosure regulation and adequate tools for its enforcement. The new s674 is well equipped with civil penalties, in addition to Schedule 3 penalties and the guidelines of the Criminal Code. The arsenal will be virtually complete if ASIC is successful in its call for the power to impose an administrative fine without application to the court.⁶⁰³ In spite of this, difficulties of definition can still hinder successful enforcement by ASIC and ASX unless a climate of self regulation permeates the corporate culture. Publicity by the regulators and corporate peer pressure are required to encourage compliance with the ‘spirit of the listing rules’.

‘Spirit’ of the Listing Rules

As previously discussed in Chapter 3,⁶⁰⁴ the format of the query notice reflects the contents of s1001A/674 and listing rule 3.1 but it also highlights the ASX dilemma of not always knowing which questions it should be asking the company. Most trading induced query notices emphasise that the company’s responsibility is not confined to, or necessarily discharged by, answering the specific requests set out in the correspondence. In the absence of a direct question from ASX, companies often fail to fulfil the expectation that they will respond with full disclosure in the ‘spirit’ of the listing rules.

Compliance with the ‘spirit’ of the rules is not only implicit in the wording of listing rule 3.1, it is stated explicitly in listing rule 19.2 that:

“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.”⁶⁰⁵

⁶⁰³ ASIC Media Release 01/283 13 August 2001; Knott, note 270 at 3, 4. See also sections on *United Kingdom* in Chapter 4 and *ASIC Enforcement Powers* in Chapter 5.

⁶⁰⁴ See sections *Abador Gold NL Query 1, Query 2, and Query 3* in Chapter 3; ASX queried Abador Gold NL concerning two perceived incidents of non-disclosure by the company. Both these queries were the result of unexplained variations in the company’s share price.

⁶⁰⁵ *ASX Listing Rules* Chapter 19 Interpretation and Definitions issued September 2001.

ASX links the above mandate specifically with the requirements of listing rule 3.1 by repeating rule 19.2 in the guidance notes for continuous disclosure. This reinforces the demand that listing rule 3.1 should not be interpreted in a restrictive or legalistic manner but must be complied with in the ‘spirit’ of continuous disclosure.⁶⁰⁶ The terms of listing rule 19.2 are repeated a third time, as part of the contractual agreement entered into by the company at the time it applies for listing on ASX.⁶⁰⁷ This contractual obligation, and its judicial endorsement in *TNT Australia Pty Ltd v Poseidon Limited (No 2)*,⁶⁰⁸ was discussed in Chapter 5 under ASX Authority in the section on *Contractual Obligation of the Listing Rules*.

As the triple inclusion of the terms of listing rule 19.2 indicates, ASX rightly attaches great importance to an interpretation of the rules in accordance with the ‘spirit’ of the regulator’s intention and purpose. It is regrettable then, on a practical level, that a company secretary or managing director of a listed company is not more directly confronted with the need for this wider interpretation when making a disclosure decision in relation to listing rule 3.1. Proximity of the listing rule to the relevant guidance note would act as a constant reminder of this wider disclosure responsibility.⁶⁰⁹ The other two references to the ‘spirit’ of the rules are positioned at the front of the *ASX Listing Rules* in the Introduction and in Chapter 1.

ASX Monitoring Prior to the Query

ASX’s regulatory authority, and the combined enforcement powers of the stock exchange and ASIC, were discussed in Chapter 5. However, the front line detection of potential breaches of the continuous disclosure and insider trading provisions usually lies with ASX Surveillance. The department’s sophisticated electronic surveillance, complemented by experienced staff, is often the only ‘alert’ to the regulators that the market is not fully informed.

⁶⁰⁶ Ibid, Guidance Note on Continuous Disclosure par 26 issued 1 July 1996, replaced by Guidance Note 8 par 30 issued September 2001.

⁶⁰⁷ Ibid, Appendix 1A ASX Listing Application and Agreement Part 3 clause 6.

⁶⁰⁸ *TNT Australia Pty Ltd v Poseidon Limited (No 2)*, note 446 at 85; Jacobs J criticised the lack of full and fair disclosure of a merger proposal and stated that a commercial document should be construed and interpreted by a Court in such a way as to give effect to the spirit and the purpose of the Rule.

⁶⁰⁹ Any reinforcement of the message is dissipated as the filing instructions for the updates to the *ASX Listing Rules*, and the sequence shown in the Contents page, indicate that the guidance notes are to be filed behind the appropriate tab at the end of the book.

Looking at the larger sample of trading induced queries, the initial statistical analysis in Tables 1.1, 1.2 and Figure 1, confirms that ASX Surveillance is targeting those stocks with unexplained abnormal trading patterns. The question then arises – is this surveillance timely and sufficient? ASX is aware of at least some of the companies with an abnormal trading pattern but, in many instances, this pattern appears to have been initiated at an earlier date than the monitoring period referred to in the query notice. Should the ASX query notice fulfil a more anticipatory warning function?

Another consideration for the regulators is whether it would unduly affect a company's share price if ASX consistently made an announcement when it issued a trading induced query to that company? This appears to occur on some occasions. However, the Signal G list of 427 queries that forms the basis of this study indicates that the ASX public release date, usually the reply date or just after, is the same for both the query notice and the company's reply. The consistent transparency gained by public release of the query notice at its time of issue would reveal any tardiness by the queried company in replying to ASX. Continued delays in providing a satisfactory explanation could be monitored and, if necessary, expose a queried company to daily fines or other appropriate regulatory measures.

It is encouraging that ASIC states in its annual report that the media has begun to publish more news about ASX's share price queries and replies.⁶¹⁰ ASIC also now regularly releases the names of those companies that it has approached with a demand for additional disclosure.⁶¹¹ Another initiative, which has since been discontinued, was the inclusion in the Market Wrap section of the Friday edition of *The Australian Financial Review*, a column on ASX queries for the week entitled 'Under Scrutiny'.⁶¹²

However, less encouraging is the revelation by ASX company secretary that a large number of stock exchange queries are still done confidentially. These queries are only disclosed to the market when ASX is initially dissatisfied with the response from a company under the spotlight.⁶¹³ This reticence

⁶¹⁰ *ASIC Annual Report 1999-2000* at 30.

⁶¹¹ For example, *ASIC Media and Information Release* 'ASIC Cracks Down on Continuous Disclosure' 01/284 13 August 2001.

⁶¹² For example, *Under Scrutiny* 'Drilled over Indonesia: ASX Queries in the Week to October 26' *The Australian Financial Review* (27 October 2000) MW3.

⁶¹³ Aylmer S 'ASX Aiming for a Better System' *The Australian Financial Review* (10 November 2000) 3, 74 (Interview with Karen Hamilton, ASX company secretary).

by ASX is surprising in light of the strengthened qualified privilege accorded such disclosures under s779(7)(a)/1100B.⁶¹⁴

Analysis of market adjusted variations of stock prices, for the two to six weeks prior to the query, indicates that the trading induced stocks move independently of the market and record strong price variations. This occurs even before commencement of the stock exchange monitoring period of approximately a week. It strengthens the argument that companies queried by ASX for abnormal price movements have a trading pattern that is significantly different to that of the technical sample, and the market, in the weeks prior to the query.

If investor anticipation of some future disclosure by the company induces these abnormal variations, could pre-emptive action by the stock exchange reduce the price volatility? Initiatives by the regulators in the ‘Continuous Disclosure Program’, discussed later in this chapter,⁶¹⁵ show commitment to a more proactive policy. However, a weakness is that the audit letter is forwarded to the queried company after an unsatisfactory reply to the query notice, whereas the period of uninformed trading and potential insider activity can occur a number of weeks prior to the query. A more timely and possibly better publicised query procedure by ASX could reduce the anticipatory market adjusted returns, which are either the deductions of an astute investor or flow from a failure of the confidentiality condition of listing rule 3.1.

ASX Monitoring After the Reply

The results in Chapter 3 convey a perception, particularly in the speculative area of the market, that once a company has provided a standard ‘fully informed’ or similar reply to the stock exchange then it has complied with its continuous disclosure obligations. The analysis of company replies⁶¹⁶ in this study reveals that, on numerous occasions, a company publicly releases material information only days after replying to ASX that the market is fully informed. There is little pretence that the company is attempting to rely on one of the ‘carve-outs’.

This conclusion is supported by the recent stance taken by the regulators. ASIC and ASX have initiated a joint assault⁶¹⁷ to force greater disclosure by those companies in the speculative mining

⁶¹⁴ See section on *ASX Enforcement* in Chapter 5.

⁶¹⁵ See later section on *Joint Policy Implementation*.

⁶¹⁶ Table 12.

⁶¹⁷ See later section on *Joint Policy Implementation*.

and technology sectors that have strong and often volatile trading. In this national surveillance programme, ASIC selectively reviews company responses to ASX trading induced queries. ASIC will also review reliance on ASX ‘carve-outs’ and has admitted that differences in the interpretation of these exemptions could be referred to the Courts. The Commission acknowledges that:

‘...a pattern is emerging where the unexplained price and volume movements continue for a fortnight or so, only to be brought to an end by the release of information to the market by the company’.⁶¹⁸

A recent study by Neagle and Tsykin analyses company responses to ASX queries and substantiates this implication that ‘sub-optimal disclosure’ continues, particularly in the speculative sectors of the market:

“...it would appear that the Query, of itself, does not always provide sufficient incentive to improve disclosure so as to avoid a repeat Query”.⁶¹⁹

The statistical results, discussed in Chapter 3 of this thesis, suggest that for some sectors of the market the regulators should not relax their vigilance once the company’s reply has been publicly released. It would be in accord with expectations of semi-strong efficiency if the trading pattern of the queried company returned to equilibrium once the market were fully informed. However, in the weeks following release of a company’s reply, the price fluctuations in the trading induced mining sector were as strong as they had been prior to the query.⁶²⁰ This phenomenon could result from slow market absorption of the information in the reply, but it is equally likely to be the result of continued anticipation of further undisclosed material information.

The continuing volatility of the share price implies that the market is not in receipt of all the relevant information. If the company is relying on a ‘carve-out’, and genuinely cannot release information to ease the price fluctuations, then a temporary halt to trading could be necessary. A suggestion that directors could request a trading halt in the company’s securities is included in most ASX trading induced query notices. As a trading halt is only available for a limited period, any continued non-

⁶¹⁸ ASIC Media Release ‘ASIC Launches National Continuous Disclosure Surveillance Program’ 00/041 1 February 2000; Main A and Beeby M ‘Corporate Watchdogs Get Tough on Disclosure’ *The Australian Financial Review* (2 February 2000) 1.

⁶¹⁹ Neagle A and N Tsykin ‘“Please Explain”: ASX Share Price Queries and the Australian Continuous Disclosure Regime’ Centre for Corporate Law and Securities Regulation, University of Melbourne 2001 1-52 at 26: the study investigated 911 queries issued by ASX in 1999 and 2000.

⁶²⁰ Mid to Post results in Tables 2.1, 2.2 and 3.2.

compliance by the company should prompt ASX to place a suspension on trading of the relevant securities.⁶²¹

ASIC reports that during the ‘Continuous Disclosure Program’⁶²² there was a decline in the number of trading halts requested by Perth companies from 27 in February to 11 in April 2000.⁶²³ This decline was accompanied by a decrease in the number of query notices sent to companies by ASX in Perth. This could be a positive indication that the companies being monitored complied with the demand for continuous disclosure in a more timely fashion and rendered a trading halt unnecessary. Alternatively, it could be simply that slower trading led to less share price volatility. A more constructive policy would be to encourage greater use of trading halts, as suggested in the ASX guidance note,⁶²⁴ rather than risk non-disclosure, premature release of information or an imposed suspension of trading.⁶²⁵

As discussed in Chapter 5,⁶²⁶ ASX is now a listed company and oriented towards strong shareholder returns. Larger institutional shareholdings are likely to result from changes to the voting limits in ASX shares from 5 to 15 per cent and this may increase pressure on its role as a market regulator.⁶²⁷ There is a potential conflict of interest for ASX if institutional trading in a company’s securities is disrupted by suspension. A suspension in trading will often antagonise both the company and potential investors. Frequent company suspensions could be a disincentive to those local and foreign

⁶²¹ See section on *Trading Halt* in Chapter 3.

⁶²² See later section on *Joint Policy Implementation*.

⁶²³ *ASIC Media Release* 00/268 22 June 2000.

⁶²⁴ *ASX Listing Rules* Guidance Note 8 Continuous Disclosure pars 34-36 September 2001.

⁶²⁵ ASX was itself tardy in imposing a trading halt on its securities on 10 October 2000. The Federal Minister for Financial Services and Regulation, Joe Hockey, announced that the maximum permissible single shareholding in ASX Limited would be increased from 5 per cent to 15 per cent. This statement was released at 11.22am but ASX was unable to call a trading halt until 11.35am. During this period, the share price rose from \$11.04 to \$11.70 and 389,712 shares in ASX were traded. Sources: Hockey J, Minister for Financial Services and Regulation ‘ASX Ownership Limits Freed Up’ *Media Release* Parliament House, Canberra 10 October 2000; Main A ‘ASX Stock Jumps as Hockey Changes Rules’ *The Australian Financial Review* (11 October 2000) 29.

⁶²⁶ See section on *ASX Enforcement* in Chapter 5.

⁶²⁷ The *Financial Services Reform Act* increases the voting power limit in ASX from 5 to 15 per cent. Any higher limit must be prescribed by regulation and is subject to a parliamentary non-disallowance period of 15 parliamentary sitting days. Members have approved a similar alteration to Article 9 of the ASX Constitution. Australian Stock Exchange Limited *Notice of Annual General Meeting 2001* at 6-7.

companies considering listing, or investing, on ASX. This conflict of interest is compounded by a decline in listing fees if a company is irrevocably removed from the Official List for a breach of the listing rules. This issue may indirectly affect ASX monitoring of a company's reply.

ASX is aware of the difficulty in allocating a market monitoring role to a fully independent entity, as the surveillance function is most effective when it is closely related to the market. Rather than divorcing surveillance from the market place, the role of ASX Supervisory Review Pty Ltd is to provide independent surveillance of the tension between the stock exchange's dual role as regulator and listed company.⁶²⁸

ASIC and ASX Policy Developments

Many of the examples referred to in Chapter 3 reflect a lack of resolution and consistency in application on the part of the regulators in enforcing continuous disclosure. The following initiatives suggest a strengthening of resolve by ASIC and ASX to combat the high level of public scepticism resulting from the total lack of prosecutions for failures of corporate disclosure.

Analyst Reports and Broker Recommendations

A number of the examples discussed in Chapter 3 referred to broker's reports or recommendations in the reply to an ASX query. In one of these instances,⁶²⁹ the company did not admit reliance on an incomplete proposal 'carve-out' but the directors suggested that the price increase could be the result of significant US buying based on positive broker recommendations. A subsequent ASX query to this company received the response that there were no matters of importance requiring disclosure other than two brokers' reports, and any material information that had been given to the brokers was already in the public domain. It is not unusual for the share price of a company to alter in response to a broker's recommendation.

⁶²⁸ Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 31; see section on *ASX Enforcement* in Chapter 5.

⁶²⁹ See section on *Digicall Group Limited* in Chapter 3; the company was responsible for the maximum price variation of the trading induced stocks in Table 1.1. The price fluctuation, of more than 300 per cent over a four month period, was queried by ASX in December 1995. This followed four earlier queries by the stock exchange and three of these were concerned with abnormal variations in the company's share price. A few days after the first query, Digicall announced the acquisition of ten retail stores. Two weeks after the third query, Digicall announced that institutions and brokers had shown significant interest in the company's US road show, which was being conducted in anticipation of the commencement of trading of American Depository Receipts.

ASX guidelines⁶³⁰ recognise the important role of analyst and broker reports in ensuring that generally available information is disseminated and ‘brought to the attention of persons who commonly invest in securities’. However, the guideline warns that it is inappropriate for a company to provide any undisclosed information. Should this occur, then the confidentiality requirement is breached and a ‘carve-out’ from disclosure ceases to be effective.

Since 1999, the regulators have directed greater attention to the information contained in analyst reports and broker recommendations. The example given above, where the reply was received after such an elongated query process, illustrates one of the main issues that ASX and ASIC have tried to confront in the discussion paper, ‘Heard it on the Grapevine...’.⁶³¹ The paper highlights situations in which companies risk selective disclosure to securities analysts and fund managers, such as road shows, presentations, individual briefings and *ad hoc* communications.⁶³² The ‘drip-feeding’ of information by some companies into the market place can enable analysts to aggregate this ‘drip’ of marginal corporate information in such a way that it becomes price sensitive.⁶³³

In the past, few companies seem to have been concerned, or fully aware, that ‘drip-feeding’ information could involve criminal liability for insider trading under the tipping provision, s1002G(3)/1043A(2). Many companies, and analysts, would argue that this information is generally available under the ‘derived information’ definition of ss1001C(3)/676(3) and 1002B(3)/1042C(1)(c). However, the regulators⁶³⁴ could rightly claim that these companies are employing a spurious dissemination procedure that does not comply with ‘generally available’ in ss1001C(2)/676(2) or 1002B(2)/1042C and is certainly not within the ‘spirit’ of the listing rules.

In the absence of clear judicial definition of ‘generally available’, ASIC guidelines are essential to practitioners to provide greater certainty in the law. With ambiguity concerning the interpretation of the continuous disclosure provision, many companies remain confused regarding the timing and

⁶³⁰ *ASX Listing Rules* Guidance Note 8 Continuous Disclosure September 2001 pars 40, 41 Analysts Reports.

⁶³¹ ‘Heard it on the Grapevine...’, note 117.

⁶³² *Ibid*, Part 3 pars 28-32.

⁶³³ Beeby M ‘Turning Inside Out’ *The Australian Financial Review* (16 November 1999) 1, 10.

⁶³⁴ ‘Heard it on the Grapevine...’, note 117, Part 3 Material and Non-material Information pars 24 to 26.

extent of disclosure to the public.⁶³⁵ As discussed in Chapter 4, the SEC also confronted this issue in August 2000 when it introduced 'Regulation Fair Disclosure' to prohibit selective disclosure of non-public information by companies to analysts and institutional investors.⁶³⁶

Joint Policy Implementation

ASIC and ASX are increasing the pressure on segments of the market to comply with the continuous disclosure regime. The regulators announced in June 2000⁶³⁷ that they would continue to widen the focus of the joint 'Continuous Disclosure Program' commenced earlier in the year.⁶³⁸ In this surveillance exercise, ASIC and ASX reviewed a selection of replies to query notices that had been issued to technology and mining companies in Perth and Brisbane.

The ASIC programme confirms the findings of the empirical study, discussed in Chapter 3, that most trading induced queries within the sample period were directed to mining companies and most queries emanated from the Perth branch of ASX.⁶³⁹ In many instances the replies were similar to those found during the study for this thesis,⁶⁴⁰ that the company was not aware of any reason for the price or volume movement and that the market was fully informed.

There is a rapid decline, over the three month time period of the initial ASIC surveillance, in the number of ASX query letters, trading halt requests and referrals of breaches of listing rule 3.1 to ASIC.⁶⁴¹ However, these positive results are more likely to be influenced by weakening technology and commodity markets, than by any great improvement in the 'best practice' of companies concerning the timely disclosure of price sensitive information. One initiative of the programme is that there is a follow up to the receipt of an unsatisfactory query notice. An 'audit letter' will ask the directors to explain in detail the basis of the company's response to ASX.

⁶³⁵ See sections on *Insider Trading Case Law* and 'Generally Available' in Chapter 5; Corlett, note 48 at 105-108.

⁶³⁶ 'Regulation Fair Disclosure Revisited', note 298 at 2; *ASIC Media Release* 00/365 23 August 2000.

⁶³⁷ *ASIC Media Release* 00/268 22 June 2000.

⁶³⁸ *ASIC Media Release* 00/041 1 February 2000.

⁶³⁹ Seventy nine of the total 187 trading induced queries in this study were sent by ASX in Perth (Table 10). Of these 187 trading induced queries, 101 were directed to mining companies (Table 11).

⁶⁴⁰ Table 12.

⁶⁴¹ *ASIC Media Release* 00/268 22 June 2000.

ASIC states that it wishes to place more emphasis on ‘best practice disclosure’. The Commission is developing consistency in its approach to reinforcing listing rule 3.1 and is doing this without emphasising the penalties of the continuous disclosure provision s1001A/674. This positive approach by the Commission is in accord with the responsive regulation of Ayers and Braithwaite that was discussed in the previous chapter.⁶⁴²

The Commission’s attitude could also be a practical realisation of the difficulty of establishing the criminal standard of proof for a serious contravention of the continuous disclosure or insider trading provisions. If ASIC’s strategy of encouragement is not successful, the adoption of a civil standard of proof and civil penalties under the replacement ss674(2) and 1317E(ja) should be of assistance.⁶⁴³

In a joint initiative, ASIC and ASX have built on the 1999 release of ‘Heard it on the Grapevine...’⁶⁴⁴ with the August 2000 release of ‘Better Disclosure for Investors’.⁶⁴⁵ These guidance rules were supported by an ASX exposure draft⁶⁴⁶ of amendments to the continuous disclosure listing rule and guidance note. Most of these revisions are incorporated in the September 2001 reissue of the listing rules. This impetus for a wider disclosure policy needs to be maintained if the corporate culture is to be gradually changed.

ASX moved to pre-empt any decline in corporate standards by proposing two listing rule initiatives in support of the concepts underlying the ASIC guidance rules:

- Nomination of a senior officer to have responsibility for continuous disclosure,⁶⁴⁷ and
- Establishment of written policies and procedures on information disclosure.⁶⁴⁸

⁶⁴² See section on ‘*Responsive Regulation*’ in Chapter 5.

⁶⁴³ See section on *Civil Penalties* in Chapter 5.

⁶⁴⁴ ‘Heard it on the Grapevine...’, note 117.

⁶⁴⁵ ‘Better Disclosure for Investors’, note 120; *ASIC Media Release* 00/365 23 August 2000.

⁶⁴⁶ ‘Proposed Listing Rule Amendments’, note 364, Section 3 Continuous Disclosure.

⁶⁴⁷ ‘Better Disclosure for Investors’, note 120, ‘Overseeing and Coordinating Disclosure’ par 3; ‘Proposed Listing Rule Amendments’, note 364, pars 3.10, 3.12-3.16.

⁶⁴⁸ *Ibid*, ‘Preventing Selective Disclosure’ par 1; ‘Proposed Listing Rule Amendments’, note 364, pars 3.10, 3.17 and 3.18.

These concepts are reflected in amended listing rules that were introduced on 30 September 2001. Condition 12 of listing rule 1.1 requires an entity, when applying for admission to ASX, to appoint a person who will be responsible for communication to the stock exchange in relation to listing rule matters. This condition applies not only to companies seeking admission but also to those already listed (listing rule 12.6). ASX must be notified of this initial appointment and any change in the person responsible for such communication (listing rule 3.16.4).

The second of the ASIC guidance rules could be incorporated into a future ASX listing rule 4.10.21 that would require an inclusion in the company's annual report of:

“A statement of the main practices and procedures for ensuring compliance with listing rules 3.1 and 15.7 that the entity had in place during the reporting period.”⁶⁴⁹

However, ASX is concerned that this additional reporting is ‘excessive and may add little value’.⁶⁵⁰ As it is still seeking a suitable mechanism to ensure sound disclosure practices, there is no decision to introduce the requirement immediately.⁶⁵¹

In a further effort to ensure that all listed companies fall within the scope of continuous disclosure regulation, ASX intends to include listing rule 3.1 as a continuing obligation for ‘Foreign Exempt’ companies from 30 June 2002. Existing listing rule 1.15.1 excludes such companies from compliance with listing rule 3.1 unless ASX specifies compliance with additional rules.⁶⁵²

Surveillance of Directors’ Trading

The empirical study for this thesis was not designed to reveal whether directors or officers of a queried company were responsible for astute investor or insider trading at a time when abnormal trading patterns were recorded. However, as discussed in the *Insider Trading* section of Chapter 5, some studies⁶⁵³ infer that insider trading is most likely to occur in the securities of more speculative companies and that the insiders are, most probably, officers of the company. There is also evidence

⁶⁴⁹ ‘Proposed Listing Rule Amendments’, note 364, par 3.25.

⁶⁵⁰ Ibid, par 3.18.

⁶⁵¹ Ibid.

⁶⁵² *ASX Listing Rules* Guidance Note 4 Foreign Entities September 2001 pars 10, 11; *ASX Media Release* ‘ASX to Amend Foreign Exempt Listing Rules’ 3 October 2001.

⁶⁵³ Tomasic (1996), note 347.

that, while a director's purchases are unprofitable, the sales are profitable as this action avoids a future loss situation.⁶⁵⁴

In addition, there are suggestions that a large proportion of company officers rely on inside information for the timing of trading decisions.⁶⁵⁵ While not conclusive, there are indications that trading by directors and other insiders exists at times when the market is less than fully informed. If this is true, then many of the abnormal returns indicated in the prior to mid period⁶⁵⁶ of the study are attributable to the informed trading of company directors and officers.

Section 205G,⁶⁵⁷ of the *Corporations Act* prescribes post-trade disclosure to ASX of a director's investment position in the company. This provision does not prohibit directors from trading on information that they acquire in their corporate capacity. The disclosure requirements of s205G need to be linked more effectively in the minds of directors with the demands of s1002G/1043A and s1001A/674 to preclude an insider from trading while in possession of undisclosed price sensitive information.

In a 1999 pilot programme,⁶⁵⁸ ASIC found that 35 per cent of the 75 directors in randomly selected companies failed to disclose their share interests within the 14 day reporting period required by s205G(3). More than two thirds of the directors reported their shareholdings between a week and three years after the prescribed period. ASIC recognised the link in directors obligations arising from the three provisions:

“Failure to comply with this obligation [s205G] could in some cases be associated with insider trading [s1002G/1043A] which in turn could be associated with a failure in listed company disclosure regime [s1001A/674].”⁶⁵⁹

ASIC appears to recognise that it is necessary to continually reinforce these surveillance initiatives if it wishes to instil continuous disclosure ‘best practice’ as a corporate aim. The Commission has

⁶⁵⁴ Brown and Foo, note 198 at 1.

⁶⁵⁵ Freeman and Adams, note 355.

⁶⁵⁶ Tables 2.1, 2.2 and 3.1.

⁶⁵⁷ CLERPA, note 59, formerly s235.

⁶⁵⁸ *ASIC Media Release 99/221* 26 June 1999.

⁶⁵⁹ *Ibid.* Section numbers have been added to the original ASIC statement to illustrate the point.

warned that it is repeating its review of directors' disclosure of their share trading. The regulator is now clearly stating that the 'continuous disclosure regime is a key platform to ensure the integrity of the market'.⁶⁶⁰ The issue is being treated more seriously, with a wider sweep of directors from both newly listed and established companies. Detection of a breach of s205G will focus the investigation on any failure to disclose price sensitive information or subsequent insider trading. Identification of non-compliance by a director for a second time is likely to lead to prosecution.⁶⁶¹ In this warning, ASIC has rightly linked directors' obligations under the three provisions, ss205G, 1001A/674 and 1002G/1043A.

As discussed in the section on Insider Trading in Chapter 5, ASX also introduced listing rules 3.19A and 3.19B to strengthen directors' disclosure obligations from 1 January 2002.⁶⁶² These rules require an entity to notify the market within five days⁶⁶³ of a director's holdings in the entity and any subsequent change to this interest.⁶⁶⁴ The company has the obligation to enforce these arrangements with the director. Where a company complies with listing rule 3.19A, the obligations of the relevant director under s205G will be considered satisfied.⁶⁶⁵

ASX Trading and Disclosure Policy

As a regulator, ASX is well aware of the three-way link between directors' failure to disclose under s205G and s1001A/674, and potential insider trading under s1002G/1043A. As a listed company since 1998, ASX now has to confront the possibility of insider trading in its own securities. To contend with this situation, ASX policy includes strict guidelines that could provide a corporate governance model for other listed companies.

⁶⁶⁰ ASIC Media Release 00/288 5 July 2000.

⁶⁶¹ Ibid, ASIC Commissioner Jillian Segal. Schedule 3 Penalty: 10 penalty units or imprisonment for 3 months or both. A penalty is \$110 (s4AA of the *Crimes Act 2001* (Cth)).

⁶⁶² *ASX Listing Rules* Amendments at 30 September 2001.

⁶⁶³ *Insider Trading Discussion Paper*, note 362 at 4.5; 'Proposed Listing Rule Amendments', note 364 at 2: ASX had originally wanted notification within two days but this was considered too short a period by a large number of respondents to the proposal.

⁶⁶⁴ Listing rule 3.19A.1 (Appendix 3X) and listing rule 3.19A.2 (Appendix 3Y).

⁶⁶⁵ *ASX Listing Rules* Guidance Note 22 Director Disclosure of Interests and Transactions in Securities – Obligations of Listed Entities pars 6, 9 and 17 issued September 2001.

Directors, officers and employees of ASX may only deal in the securities of the company in the four weeks following the expiration of two business days immediately after an announcement of the company's financial results or information concerning a new share issue. Influenced by ss1001A/674 and 1002G/1043A, ASX prohibits trading even during this restricted four week period if the person is in possession of unpublished information, which if generally available might affect the price or value of the securities. This current position represents a restriction on the wider trading window of six weeks that was previously adopted by ASX.⁶⁶⁶

ASX's recognition of the need to allow for a reasonable period of dissemination of information as required by ss1001C(2)(b)(ii)/676(2)(b)(ii) and 1002B(2)(b)(ii)/1042C(1)(b)(ii) is of interest. ASX requires two days⁶⁶⁷ as a reasonable period for dissemination of an announcement and this period must expire before the four week trading window can commence. Permission to trade in ASX securities outside this designated period may be obtained from the managing director or chairman only in exceptional circumstances. ASX directors are also required to report quarterly on any dealings they have had in the company's securities.⁶⁶⁸ This is in addition to their reporting requirements under the *Corporations Act*.

ASX, using its own corporate governance standards as a model, could offer greater assistance to companies listed on the stock exchange. As previously discussed,⁶⁶⁹ ASX requests that additional information be included in a company's annual report if it has an audit committee or other corporate governance practices (listing rules 4.10.2. and 4.10.3). It is understood that, to date, ASX has resisted introducing new listing rules demanding specific corporate governance practices. However, this does not preclude the stock exchange from revising its guidance note on Disclosure of Corporate Governance Practices⁶⁷⁰ to include the policy model on employee share trading, disclosure and insider trading prevention that it has adopted as its own standard.

⁶⁶⁶ Australian Stock Exchange Limited *Annual Report 1999* 'Corporate Governance' at 34. Discussion of these limitations on the securities trading activities of ASX directors and staff were not included in the *ASX Report to Shareholders 2000* but have been restored with the revised four week trading window in the *ASX Report to Shareholders 2000/2001* at 37.

⁶⁶⁷ *ASX Report to Shareholders 2000/2001* at 37

⁶⁶⁸ *Ibid.*

⁶⁶⁹ See section on *Periodic Disclosure* in Chapter 2.

⁶⁷⁰ *ASX Listing Rules* Guidance Note 9 on Disclosure of Corporate Governance Practices issued 16 November 1998.

The introduction of listing rules 3.19A and 3.19B, discussed previously, to reduce a director's disclosure obligation to five days is complemented by the addition of Item 10 of ASX's indicative list of corporate governance matters. ASX does not include its own trading window as an example but, when making a statement to be included in its annual report under listing rule 4.10.3, a company can take into account:

“The entity's policy on the trading of its securities by directors and employees, including the uses of trading windows.”⁶⁷¹

ASIC's revised guidance principles are also moving closer to these governance standards as they encourage, but do not mandate, that a company should nominate a senior officer who will be responsible for ensuring compliance with listing rule 3.1. Compliance officers will co-ordinate disclosure to ASX, the public and other interested parties such as analysts and shareholders.⁶⁷² This guideline supports an Australian compliance industry.⁶⁷³ As discussed previously,⁶⁷⁴ the revised ASX listing rules have adopted this practice from September 2001. ‘Given its market position, ASX considers that it has a responsibility to lead by example in complying with the continuous disclosure regime’⁶⁷⁵ and to this end it has established its own procedures for compliance with listing rule 3.1 and has appointed a Continuous Disclosure Officer.

Internal compliance systems gained importance following directors' awareness of their potential liability in the wake of *AWA v Daniels*.⁶⁷⁶ In response to this perception, a category of compliance professionals has emerged to ‘assist the organisation in remaining a good corporate citizen’.⁶⁷⁷ In the event of a breach of duty of care and diligence in common law, equity or s180(1), strong compliance procedures can assist directors with a ‘business judgment’ defence under s180(2).⁶⁷⁸

⁶⁷¹ ‘Proposed Listing Rule Amendments’, note 364 at 2; *ASX Listing Rules* Guidance Note 9 Corporate Governance at 40 and Attachment – List of Corporate Governance Matters Item 10.

⁶⁷² *ASIC Media Release* 00/365 23 August 2000.

⁶⁷³ Parker C ‘The Emergence of the Australian Compliance Industry: Trends and Accomplishments’ (1999) 27 *Australian Business Law Review* 178-195.

⁶⁷⁴ See section on *Joint Policy Implementation* in this chapter.

⁶⁷⁵ Australian Stock Exchange Limited *Report to Shareholders 2000/2001* at 37.

⁶⁷⁶ *AWA Ltd v Daniels (trading as Deloitte Haskins & Sells)* (1992) 7 ACSR 759.

⁶⁷⁷ Parker, note 673 at 180, 185 and 188.

⁶⁷⁸ See section on *Business Judgment Rule* in Chapter 5.

Summary

In this chapter, conclusions have been drawn from the results of the empirical analysis of ASX queries in Chapter 3. The implication of these issues for the stock exchange's approach to surveillance, and other regulatory procedures of ASIC and ASX, were considered under the main headings of Regulatory Choice, the link between Continuous Disclosure and Insider Trading, the Regulatory Tools and recent ASIC and ASX Policy Developments. The arguments concerning continuous disclosure will be concluded in the following Chapter 7.

Chapter 7

Conclusion

The need for a statutory based regime of continuous disclosure was first canvassed by CASAC in June 1991 at the direction of the Attorney General. This resulted in the report on Enhanced Statutory Disclosure⁶⁷⁹ that recommended a number of reforms to the *Corporations Act*. Following discussion of this report, the continuous disclosure provision, s1001A/674, was introduced from 5 September 1994 to complement enhanced disclosure and reinforce ASX listing rule 3.1. The provision, and the revised listing rule 3.1, require listed companies to notify ASX immediately if there is any information that would be expected to have a material effect on the share price of the company.

The mandate of this amendment to the *Corporations Act* was that intentional or reckless non-disclosure was an offence,⁶⁸⁰ which could expose a listed company, and its directors, to pecuniary penalties and imprisonment of up to five years.⁶⁸¹ Potential criminal liability under this statutory provision was balanced by the insertion of ‘carve-outs’ into ASX listing rule 3.1. These exemptions enable a company to avoid disclosure, usually when information is related to an incomplete proposal or negotiation. However, this avoidance is only legitimate while the material information remains confidential within the company. The results of the empirical study, discussed in Chapter 3, illustrate the tension between continuous disclosure and confidentiality.

The argument of this thesis, as stated in Chapter 1, is that mandatory continuous disclosure under s1001A/674 and ASX listing rule 3.1 has been of limited effectiveness as a form of regulation. This is because:

- many companies, relying on the ‘carve-outs’ in listing rule 3.1.3, fail to publicly release material information in a timely manner, and
- while relying on these ‘carve-outs’, many companies fail to maintain confidentiality of the undisclosed information as required by s1001A/674 and listing rule 3.1.2.

In this thesis, empirical evidence was used to investigate 427 queries made by ASX to listed companies, and to isolate those instances where there could be a contravention of the law. A sample

⁶⁷⁹ CASAC (1991), note 2 at 1.

⁶⁸⁰ Section 1001A(3)/674(2) Note 1.

⁶⁸¹ Schedule 3 Penalties, note 19.

company's stock market performance, both before and after an ASX query, and the company's reply to the query were analysed to detect potential reliance on the disclosure 'carve-outs'. The results of the study suggest abnormal trading patterns for some queried stocks, particularly in the mining sector, for approximately two weeks prior to ASX's monitoring period. This indicates a probable failure to provide material price sensitive information, and also a failure to maintain confidentiality of the information.

Possible over reliance by directors on the exemptions or confidentiality 'carve-outs' to listing rule 3.1 is evident. Although compliance with s1001A/674 is mandatory, the timing and extent of the disclosure or the decision to rely on a 'carve-out' is at the directors' discretion. This non-disclosure period is then susceptible to a breach of information confidentiality and resultant insider trading, even by the directors of the company. Stricter guidelines, similar to those employed by ASX Limited,⁶⁸² are warranted to prohibit and supervise trading by officers and employees of a listed company.

Since its introduction, there has been no conviction for a contravention of the continuous disclosure provision. As indicated by this study, there are numerous incidents of suspected non-disclosure that, if pursued by the regulators, could provide evidence of a contravention of s1001A/674. If this is the case, then reasons for the paucity of prosecutions are likely to fall into one of the following categories:

- the difficulty of establishing the criminal standard of proof;
- the fact that the statutory provision does not stand alone but supports the ASX listing rules (s1001A(1)(b)/674(1)). Results of the empirical study indicate that the 'carve-outs' to listing rule 3.1, particularly that of an 'incomplete proposal', can act as a *de facto* defence to an accusation of non-compliance with the continuous disclosure provision;
- a final reason could be recognition by ASIC of the expense and potential ineffectiveness of prosecuting a company for intentional non-disclosure, when what is required is a change in the corporate culture of all companies.

The deterrent effect of criminal prosecution has been largely wasted as directors and company officers are not mindful of the liability associated with s1001A/674, or are dismissive of its imposition. Expansion of the civil penalty regime, with its more attainable civil standard of proof, may be a greater deterrent. Future evaluation of the effectiveness of the continuous disclosure provision could involve commissioning a report, similar to CASAC (1996), within a reasonable

⁶⁸² See section on *ASX Trading and Disclosure Policy* in Chapter 6.

period, after the application of civil penalties by the *Financial Services Reform Act* to the replacement provision s674.

Particularly since 1999, ASIC is seen to rely on publicity, surveillance and supervision, rather than statutory means, to instil a culture of compliance with the demands of full and timely continuous disclosure. Ongoing remedies, such as enforceable undertakings, could prove more effective in the long term while still exposing a delinquent company to the deterrent of unwanted publicity. As discussed in the previous chapter, company disclosure will be stimulated by ASIC initiatives such as encouraging press publication of ASX queries and replies, press releases concerning ongoing surveillance of directors' trading and maintaining public pressure on those corporate sectors susceptible to non-disclosure.

Increased periodic reporting is now being used by ASIC and ASX almost as a penalty for a company's failure to comply with continuous disclosure obligations.⁶⁸³ Full and timely continuous disclosure is always preferable to the more structured and delayed disclosure available in periodic reports. However, for those companies with a predilection against disclosure on a continuous basis, possibly through illegitimate reliance on 'carve-outs', increased periodic reporting should be reconsidered. Quarterly reporting could be an effective, if unwelcome, control in reducing the amount of time during which the market remains uninformed.

In a dynamic market place, static corporate regulation is likely to become unenforceable or ignored. To avoid this, legislative and regulatory measures must continually adapt, as timely disclosure will become more difficult to enforce in an increasingly global market place. The main prompt for better disclosure practices could come from participants in the market, rather than the regulators. Not only from the institutions and other corporations, but also from the increasing number of private investors who require better information in order to balance the risks and returns of their portfolios. If there is value in the continuous disclosure provision, it is its potential to raise the consciousness of directors to an awareness of investor demands for timely and material information to be disclosed within the 'spirit' of the regulation.

⁶⁸³ *ASIC Media Release 98/277* 11 September 1998 and *98/343* 12 November 1998: Crown Casino agreed to report quarterly. See also section on *Periodic Disclosure* in Chapter 2.

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