QUESTIONS ON FOREIGN SYSTEMS

INNACURATE STATEMENTS MADE TO THE MARKET: AUSTRALIAN LAW[*]

1. Does the law in principle impose liability for market statements?

Yes. The law imposes criminal and civil liability for market statements.

Given the focus of this study, it is not proposed to discuss the criminal liability regime.

Civil liability may be imposed for market statements under the *Corporations Act 2001* (Cth) ('Corporations Act') and the *Australian and Investments Securities Act 2001* (Cth) ('ASIC Act') arising out of a breach of the:

- continuous disclosure requirements under the Corporations Act; and
- misleading and deceptive conduct provisions under the Corporations Act, ASIC Act and/or the *Trade Practices Act 1975* (Cth) ('TPA').

2. If so, does it distinguish between different types of statement eg statements made in periodic reports (yearly or half-yearly or others), statements required to be made to the market, for example, about significant events affecting the company, voluntary statements made by companies to the market?

Yes.

(a) Continuous disclosure requirements

The continuous disclosure regime of the Corporations Act applies to listed and unlisted entities.[1]

Under s 674 of the Corporations Act, civil liability is imposed on a listed disclosing entity[2] for failure to comply with their disclosure obligations under ASX Listing Rule 3.1 in respect of certain types of information. Under s 674, entities are required to disclose information to the market, where that information is:

- information required to be notified to the ASX under ASX Listing Rules;[3]
- not generally available; and
- information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the securities of the entity.[4]

---

[*] Joanna Hemingway, LLM Candidate, LSE, and Solicitor admitted in NSW, Australia. This paper is current to January 2007.

[1] I note that liability for conduct breaching the Continuous Disclosure Requirements may also arise under the common law torts of deceit or misstatement. However, it is not proposed to address these potential common law remedies. Note that s 674(4) of the Corporations Act which expressly preserves the application of other legal remedies for a contravention of conduct falling within the continuous disclosure requirements.

[2] 'Disclosing entity' is defined in s 111AC.

[3] ASX Listing Rule 3.1 provides that a listed entity has an immediate disclosure obligation when it becomes aware of 'any information that a reasonable person would expect to have a material effect on the price or value of its securities'.

[4] 'Materiality' is defined in s 677 as information that would be or is likely to influence persons who commonly invest. The case law in relation to 'materiality' indicates that is a non-technical concept, and materiality is established by reference to an objective assessment of what a reasonable investor would consider as relevant

Section 675 of the Corporations Act is to similar effect in relation to unlisted entities or other entities not bound by ASX Listing Rule 3.1. However, disclosure of the information is required to be made to ASIC, rather than the ASX.

(*Note*: reference in this paper to the 'continuous disclosure requirements or provisions' under the Corporations Act, is a reference to the obligations imposed by sections 674 and 675.)

Golding and Kalfus state that purpose of the continuous disclosure requirements is to ensure investors have equal and timely access to information, to enable them to make informed choices.[5] They also suggest that the content of the continuous disclosure regime in Australia 'bears a close similarity' to the current UK regime.[6]

<u>Civil penalty regime</u>

Part 9.4AA of the Corporations Act gives ASIC a power to fine an entity for breaches of the continuous disclosure requirements. The introduction of the civil penalty regime as part of the 2004 corporate law reforms[7] was controversial.[8] ASIC has stated its intention to use this power only for 'less serious breaches' of the continuous disclosure requirements.[9] To date, it appears that ASIC has only issued one infringement notice.[10]

Under these provisions ASIC may issue an 'infringement notice' to a disclosing entity if it has 'reasonable grounds to believe' that the entity has contravened continuous disclosure requirements,[11] imposing a penalty for the contravention.[12]

---

the disclosure issue being assessed: G Golding and N Kalfus, 'The Continuous evolution of Australia's continuous disclosure laws', (2004) 22 *C&SLJ* 385, at p 391.

[5] Golding and Kalfus, at p 387.

[6] Ibid, at p 421.

[7] *Corporate Law and Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth), also known as 'CLERP 9', which commenced on 1 July 2004.

[8] Golding and Kalfus, at n163, state there were four main reasons for opposition: (a) the penalty power invests ASIC with judicial power, in contravention of Chpt III of the Constitution; (b) is inappropriate from a due process perspective because it gives ASIC the power to be 'investigator, judge and jury on a violation of such a subjective disclosure issue' as continuous disclosure; (c) ASIC had not yet fully tested its existing enforcement powers under the civil liability proceedings provisions, and hence, no determination could be made about the 'sufficiency' of the existing regime; and (d) ASIC had not built upon the 'early promise of other sanctions such as enforceable undertakings'.

[9] ASIC Guide, *Continuous Disclosure Obligations: Infringement Notices* (ASIC, 2004), at [4], available at www.asic.gov.au ('ASIC Continuous Disclosure Guide'). The guide outlines the way in which ASIC intends to exercise its power under Pt 9.4AA.

[10] This was issued by ASIC on 1 August 2005 to Solbec Pharmaceuticals Limited, on the basis that Solbec breached s 674(2) by failing to notify the ASX about the 'structure, size and limited nature of the results of an animal study relating to its cancer drug, Coramsine'. Solbec complied with the notice and paid a penalty of A$33,000.

[11] s 1317DAC(1). Note that in determining whether to issue an infringement notice, ASIC must have regard to any 'guidelines issued by the relevant market operator for the listed disclosing entity that relate to the provisions of the listing rules referred to in subsection 674(1)': s 1317DAC(2).

[12] s 1317DAE(1)(g). Fines are tiered: A$100,000 if the entity has a market capitalisation of A$1 Billion or more (Tier 1 entity); A$66,000 for capitalisation exceeding A$100 million (Tier 2 entity); A$33,000 for capitalisation of less than A$100 million (Tier 3 entity).

Compliance with the notice is deemed not to be an admission of guilt or liability, or as indicating that an entity has contravened the continuous disclosure requirements.[13] Compliance also precludes criminal and civil proceedings being commenced or continued in respect of the same conduct.[14] However, there are two important qualifications to this:

- First, the civil penalty regime only operates as against disclosing entities, and as such, payment of a penalty does not preclude accessory criminal or civil liability.[15]

- Second, payment of a penalty does not preclude proceedings being brought against the entity by a person (or ASIC on their behalf)[16] who has suffered loss or damage as a result of conduct contravening the continuous disclosure provisions.[17]

(b) Periodic or episodic disclosure

The Corporations Act also imposes liability for contravention of periodic disclosure obligations. For instance, failure to comply with:

- Financial reporting obligations (see s 344 of the Act).

- Disclosure obligations in relation to takeover and compulsory acquisition and buy-out documents and other offer documents (see, for instance, s 670B, s 729). These disclosure obligations generally require directors, officers[18] or advisors of a company etc in relation to a take over, or buy-out etc or persons offering securities to ensure that persons receive offer documents that contain information that 'investors and their professional advisers would reasonably require to make an informed assessment' of the relevant matters, and are not misleading and deceptive (see, for instance, s 670A and s 728).

  Section 1324 also imposes civil liability in relation to sections 1308 and 1309, which, generally, make it unlawful for an officer to give (or authorises or permits the making available) information to directors, or a member or the ASX (in the form of a document lodged or statement made), where:
  - the information relates to the affairs of the corporation; and, either:
  - is to the knowledge of the officer false or misleading (by positive statement or omission); or

---

[13] s 1317DAF(4). ASIC must makes statements to this effect in its publication of compliance with infringement notices: s 1317DAJ(3)(b)(v), (vi).

[14] s 1317DAF(5).

[15] Accessory liability under the continuous disclosure regime is discussed in point 5, in the text. ASIC specifically notes that 'compliance with an infringement notice does not preclude it from taking civil penalty proceedings against accessories': ASIC Continuous Disclosure Guide, at [33].

[16] Termed 'public interest proceedings' in s 1317DAF(6), within the meaning of s 50 of the ASIC Act. Section 50 empowers ASIC to commence and carry on proceedings in the name of a person who has suffered loss or damage, with that persons consent.

[17] s 1317DAF(6), which proceedings are termed 'compensation proceedings'. 'Compensation proceedings' are defined in s 9 as being: (a) proceedings under section 1317HA; (b) proceedings under section 12GF of the ASIC Act in relation to a contravention of section 12DA of that Act; and (c) any other proceedings by a person for compensation for loss or damage suffered by the person.

[18] *Officer* is defined in s 9 to include: officers of a corporation or unincorporated entity: a director or secretary of the corporation; or partner; or a person who: (a) makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or (b) who has the capacity to affect significantly the corporation's financial standing; or (c) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation); or receivers, administrators, liquidators, or a trustee administering a compromise or arrangement made between the corporation and someone else.

- the officer did not take reasonable steps to ascertain whether the information was false or misleading.

- ASX Listing Rules (including rule 3.1) (see, s 793C).

(c) Misleading and deceptive conduct provisions
In addition to specific misleading and deceptive conduct obligations in relation to particular types of periodic disclosure, the Corporations Act also contains general misleading and deceptive conduct provisions, in sections 1041E to 1041H of the Act. Section 1041I imposes civil liability for breaches sections 1041E to 1041H of the Act.

Misleading and deceptive conduct
Section 1041H of the Corporations Act and s 12DA of the ASIC Act impose civil liability on disclosing entities and accessories who engage in misleading and deceptive conduct.[19] Section 1041H very simply provides:

> A person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive.[20]

False and misleading statements of information
Section 1041E makes it unlawful for any person to make a statement or disseminate information that is, (a) false in a material particular, or materially misleading; (b) likely to induce a person to apply, or acquire or dispose of financial products, or effect the price of financial products; and (c) the person making the statement knows (or ought to have known) that the information was false or misleading, or does not care whether the information is true or false.

Section 1041F makes it unlawful for a person to induce another to deal in financial products by making a statement if the person knows or is reckless to whether the statement is misleading, false or deceptive, or by dishonest[21] concealment of material facts.

Dishonest conduct
Note that s 1041G makes it unlawful to 'engage in dishonest conduct' in the course of carrying on a financial services business, or in relation to a financial product or financial service'. 'Dishonest' is defined as being 'dishonest according to the standards of ordinary people, and known by the person to be dishonest according to the standards of ordinary people'.

While sections 1041E, 1041F and 1041G have been in the Corporations Act for a number of years, they have been rarely used.[22]

(d) Enforceable undertakings
A further way in which civil liability for statements to the market may be imposed (though more indirectly) is via enforceable undertakings.

---

[19] Liability for misleading and deceptive conduct may also arise under s 52 of the *Trade Practices Act 1974* (Cth) ('TPA'). However, it is not proposed to discuss that here as the misleading and deceptive conduct provisions in the Corporations Act (and ASIC Act) are based on s 52, and have been interpreted consistent with existing jurisprudence on s 52.

[20] s 12DA of the ASIC Act is in almost identical terms: 'A person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive'.

[21] 'Dishonest' is defined in s 1041F as: '(a) dishonest according to the standards of ordinary people; and (b) known by the person to be dishonest according to the standards of ordinary people'.

[22] Golding and Kalfus, at p 402.

Under s 93AA of the ASIC Act,[23] ASIC may accept an enforceable undertaking given by 'a person' instead of taking civil proceedings (or other administrative action). ASIC states that it 'will generally only consider accepting an enforceable undertaking when': it has considered starting civil enforcement action; and 'considers the undertaking to be an appropriate regulatory outcome having regard to the significant of the issues concerned to the market and community'.[24]

Enforceable undertakings may include a range of undertakings, tailored to the specific circumstances. ASIC specifies as examples, undertakings to 'pay damages to identified third parties', 'inform the market to correct some previous false or misleading disclosure or any continuing misapprehension for which it is responsible' and 'set up and implement an internal compliance place and to report periodically to the market'.[25] A recent undertaking including such provisions is that given by Multiplex Limited, on 20 December 2006.[26]

ASIC may institute court proceedings for failure to comply with an undertaking (or term of an undertaking),[27] and seek orders, including an order directing the person to comply with a term of the undertaking, to compensate any other person who has suffered loss or damage as a result of the breach of the undertaking, or any other order.[28]

3. What is the basis for such liability: negligence, intention, recklessness, strict?

The basis for liability varies.

(a) Continuous disclosure provisions

No fault element. Golding and Kalfus suggest that this is, 'unfortunate from a policy perspective as there is no defence available for the exercise of care and the application of process to the disclosure decision, beyond the general power of the court to excuse a person from liability' under s 1317S of the Corporations Act (see below).[29]

Accessory defence: accessories have the benefit of a due diligence defence:[30] they will not be liable where they can establish that they: (a) took all steps that were reasonable in the circumstances to ensure that the entity complied with its continuous disclosure obligations; and (b) believed on reasonable grounds that he entity was complying with its obligations under s 674.[31]

Court's general discretion: Under s 1317S, the court also has a general discretion to relieve a person wholly or fully from liability under sections 674 and 675 where: (a) 'the person has acted honestly'; and

[23] s 93A of the ASIC Act gives ASIC a similar power in relation to the responsible entity of a registered scheme.

[24] ASIC, *Practice Note 69: Enforceable Undertakings*, at [69.10], available at www.asic.gov.au

[25] Ibid [69.17].

[26] This was the enforceable undertaking attached to your email. Note that the undertaking itself may be required to be disclosed to the market.

[27] s 93AA(3) ASIC Act.

[28] s 93AA(4) ASIC Act.

[29] Golding and Kalfus, at p 395.

[30] ss 674(2A) and 675(2A).

[31] ss 674(2B) and 675(2B).

(b) 'having regard to all the circumstances of the case … the person ought fairly to be excused for the contravention'.[32]

(b) Misleading and deceptive conduct provisions

The fault elements in relation to the misleading and deceptive conduct provisions vary with the specific offence. In the main, liability ranges from intention to negligence. For instance, the basis of liability in sections 1041E to 1041G ranges from intention (dishonest intent: s 1041G, also s 1041F) to recklessness (sections 1041E and 1041F), and negligence (in the sense of failure to carry out due diligence, sections 1041E and 1041F).[33]

However, there is one important exception, s 1041H which is a strict liability offence. Consistent with the case law in relation to s 52 of the TPA, the court has declined to 'introduce intent limitations or negligence criteria' into s 1041H of the Corporations Act (or its predecessors, or s 12DA of the ASIC Act).[34]

Nor does s 1041H mandate any particular disclosure standard relevant to determining the existence of a misstatement: misleading and deceptive conduct is a question of fact to be determined in light of all the surrounding facts and circumstances.

Golding and Kulfus suggest that the 'low threshold of applicable culpability has the inevitable result that the misleading and deceptive conduct provisions are the preferred avenue for seeking to recover civil damages'.[35]

Establishing misleading and deceptive conduct: principles applied by the courts in the securities context

The general principles applicable to cases involving misleading and deceptive conduct in the securities context were set out by the Full Federal Court in *Fraser v NRMA Holdings Ltd*,[36] and applied in *GPG v GIO Holdings Ltd* (see below).[37] The relevant principles can be summarised as follows:

(a) In misleading and deceptive conduct cases the question is whether, having regard to all the relevant factual circumstances, by "what was said and what was left unsaid", there was conduct that was or was likely to have been misleading or deceptive.[38]

---

[32] Note s 1317S applies to 'civil penalty provisions' which are defined as those offences listed in s 1317E, and include s 344 (financial reports), s 674 and s 675 (continuous disclosure). In general, they do not include the misleading and deceptive conduct provisions.

[33] For example: *s 1041E*: a person breaches s 1041E where, at the time of making the statement, the person did not care whether the statement or information was true; or they knew, or ought to have known that the statement was false in a material particular, or materially misleading. *s 1041F*: a person breaches s 1041F where they induce another person to deal in financial products by making a statement that they know, or are reckless as to whether, the statement is false or deceptive; or by the dishonest concealment of material facts; or recording or storing information that they know to be false and deceptive where they had reasonable grounds for expecting that it would be available to a class of persons including the person induced.

[34] The Full Federal Court took this approach in relation to the application of s 52 to the securities context in *Fraser v NRMA Holdings* (1994) 14 ACSR 656, affirmed on appeal to the Full Federal Court in (1995) 15 ACSR 590. See Golding and Kalfus, at n 132.

[35] Golding and Kalfus, at p 402.

[36] (1995) 127 ALR 543.

[37] (2001) 117 FCR 23; 191 ALR 342; [2001] FCA 1761 at [100].

[38] *Fraser v NRMA* (1995) 127 ALR 543, at p 555.

(b) There is no requirement of knowledge or fault on the part of the corporation, and a contravention may occur notwithstanding the exercise of reasonable care.[39] Note, however, in *GPG v GIO*, Giles J considered the state of the knowledge of GIO (through its directors) to determine whether the 24 September 1999 statement to the market was or likely to be misleading or deceptive (see below).[40]

(c) The onus is on the plaintiff to establish "how or in what manner that which was said involved error or how that which was left unsaid had the potential to mislead or deceive". Further, "errors and omissions to have [the] potential [to mislead or deceive] must be relevant to the topic about which it is said that the [defendant's] conduct is likely to mislead or deceive". Materiality is particularly important in cases where there are "difficult questions of commercial judgement and matters of degree and conjecture".[41]

(d) There is no particular disclosure standard against which to determine whether a statement is misleading or deceptive or likely to mislead or deceive, though the question of whether conduct is misleading or deceptive is to be considered by reference to the section of the public to which the conduct is addressed.[42] Hence the standard is not the 'reasonable' investor.[43] However, note that, in *Fraser v NRMA*, the Full Court referred to the obligation to ensure full and fair disclosure having to be balanced against the prospectus being "intelligible to reasonable members of the class to whom it is directed".[44] Similarly, in *GPG v GIO Holdings Ltd*, Giles J referred to the "reasonable reader" in assessing the meaning of the terms of the statement (see below).[45]

Limitations on damages

However, there is some limitation on the breadth of s 1041H at the damages stage where there is (broadly speaking) contributory negligence, and lack of intention. Section 1041I (1B) limits damages for economic loss or damage to property recoverable for a breach of s 1041H 'to the extent that the court thinks is just and equitable having regard to the claimant's share in the responsibility for the loss or damage', where:

- the applicant suffered the loss or damage, as a result partly of their failure to take reasonable care; and partly as a result of the defendant's conduct; and
- the defendant did not intend to cause the loss or damage, and did not fraudulently cause the loss or damage.[46]

Section 1044B (limitation imposed by State and Territory professional standards law) also potentially limits the amount of damages recoverable.

Accessory liability

The question of the degree of participation required to establish accessory liability under general misleading and deceptive conduct provisions (such as under s 1041H or s 52 of the TPA) in the securities context is not settled.[47]

---

[39] Ibid at p 556, applying *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, at p 197.

[40] (2001) 117 FCR 23; 191 ALR 342; [2001] FCA 1761 at [100] – [102].

[41] Ibid at 556.

[42] Ibid at 555, 556.

[43] Golding and Kalfus, at n 135.

[44] Ibid.

[45] (2001) 117 FCR 23; 191 ALR 342; [2001] FCA 1761, at [101].

[46] s 1041I(1B).

As a matter of general law, to establish accessory liability, it must be established (on the balance of probabilities in civil matters) that the accessory: helped encourage or induce the principal offender to commit the offence, and knew the essential matters which constituted the offence.[48] Golding and Kalfus suggest that, in relation to the first element, 'it has long been a feature of the law of accessory liability that the accessory must perform an act which in some way assists the contravention of the offence in question'.[49] In *NRMA v Morgan*,[50] where it was alleged that the legal advisors and legal counsel providing written advice in connection with a prospectus were involved in a civil contravention of s 52, Giles J at first instance, held that knowledge of the essential facts alone is not sufficient to establish accessorial liability and that 'only in unusual circumstances would an advisor incur accessorial liability' – in other words there needed to be a level of participation beyond just knowledge.[51] However, Golding and Kalfus suggest that in the appeal judgement in this case,[52] the NSW Court of Appeal appeared in obiter comments to endorse a lower degree of participation.[53]

(c) Periodic disclosure provisions

The basis of liability again depends on the particular provision alleged to have been breached. Broadly speaking, liability for periodic disclosure is negligence based (in the sense of lack of due diligence). For example, s 344 provides that a person acts unlawfully where they fail to 'take all reasonable steps to comply with or to secure compliance with', the Parts 2M.2 and 2M.3 of the Corporations Act (financial records and reporting provisions).

However, in other provisions, the Act imposes strict liability but goes on to provide due diligence, lack of knowledge and reasonable reliance defences. For example, s 728 and s 729 impose strict liability for failure to make relevant disclosures, but sections 731 to 733 make certain defences available: a due diligence defence (s 731)[54] and lack of knowledge defence (s 732)[55] in relation to particular types of disclosure documents. In addition, s 733 provides a general 'reasonable reliance' type defence.[56] Note also, that s 728(2) specifically provides that, for the p urposes of s 728, a statement about a future matter will only be misleading where the person does not have 'reasonable grounds for making the statement'.

---

[47] Golding and Kalfus, at p 398-399.

[48] *Giorgianni v The Queen* (1985) 156 CLR 473; *Yorke v Lucas* (1985) 158 CLR 661.

[49] Golding and Kalfus, at p 397.

[50] (1999) 31 ACSR 435.

[51] Ibid, at 794.

[52] *Heydon v NRMA Ltd* (2000) 36 ACSR 462; [2000] NSWCA 374.

[53] Golding and Kalfus, at p 399.

[54] s 731 provides a defence where the person made all inquiries (if any) that were reasonable in the circumstances; and after doing so, believed on reasonable grounds that the statement, or omission, was not misleading or deceptive.

[55] s 732 provides a defence where the person did not know that the statement, or omission, was misleading or deceptive. Section 670D provides a similar defence in relation to sections 670A and 670B.

[56] s 733, provides a defence where the person placed reasonable reliance on information given to them by:

- in the case of a body, someone other than a director, employee or agent of the body;
- in the case of an individual, someone other than an employee or agent of the individual; or
- in the case of a person who is named in a disclosure document as being a proposed director or underwriter; or making a statement included in the document; or making a statement on the basis of which a statement is included in the document, the person is not liable if they publicly withdrew their consent to being named in the document in that way.

Section 670D provides a similar defence in relation to proceedings under sections 670A and 670B.

Liability under sections 1308 and 1309 is also mixed: s 1308(1) is a strict liability offence; sections 1308(2) and 1308(8) are based on intention. While s 1308(4) appears to operate as a due diligence offence in relation to s 1308(1), this is unclear. Liability under s 1309(1) is also mixed intention based and negligence based.

4. What is the range of claimants? (For example, only those who buy shares or also those who sell or hold shares).

There is a broad range of claimants; in general claimants need only be:

- 'a person whose interests are, have been or would be affected by past, present or proposed conduct' that would constitute a contravention of the Corporations Act (see s 1324, injunctions);[57] or

- 'a person who has suffered, or is likely to suffer, loss of damage' as a result of conduct contravening the disclosure provisions (see s 1325,[58] s 1041I); or

- 'a person aggrieved' (see s 1101B, consequential orders for contravention of ASX Listing Rules pursuant to s 793C).

Civil penalty provisions
Only ASIC can seek a 'pecuniary penalty order', once a declaration of contravention of the continuous disclosure provisions, and/or financial reporting provisions is made by the court.[59]

Enforceable undertakings
ASIC is also the only party that can enforce an undertaking given to it under s 93AA of the ASIC Act.

5. What is the range of defendants (company only, directors, advisers)

The range of potential defendants is potentially broad: entities, directors and other officers, advisors or persons involved in a contravention, though much will depend on the specific provisions involved.

Continuous disclosure requirements: disclosing entities (such as companies, some unit trusts etc) are liable under the continuous disclosure provisions (whether listed or unlisted).

In addition, 'any person involved' in a contravention of the continuous disclosure obligations may also be liable.[60] The term 'involved in a contravention' is defined in s 79 of the Corporations Act to include a person who:

- has aided, abetted, counselled or procured the contravention;

- has induced, whether by threats or promises or otherwise, the contravention;

---

[57] An injunction may also be sought under s 12GD ASIC Act in respect of conduct that relevantly, has, is or may constitute a contravention of s 12DA.

[58] Note that Golding and Kalfus (at p 397) suggest that, prima facie, it unclear whether s 1325 is restricted to circumstances where proceedings are brought under other provisions, but that the better view is that the remedies under s 1325 are available independently of the commencement of proceedings under other provisions.

[59] s 1317G and s 1317E(1), which sets out the civil penalty provisions as including s 674(2), (2A), s 675(2), (2A) (continuous disclosure), and s 344 (financial records and reporting).

[60] ss 674(2B) and 675(2B).

- has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or

- has conspired with others to contravene the Act.

Misleading and Deceptive Conduct Provisions: generally 'any person' that engages in conduct that is misleading or deceptive, or likely to mislead or deceive is liable. The degree to which an 'accessory' is liable is discussed in point 3, above.

Periodic Disclosure: again, possible defendants will range from an entity to directors or officers, underwriters of a prospectus, financial services licensees, advisors and other persons named in a prospectus (see, for instance, s 670B and sections 1308 and 1309), depending on the particular provision involved.

6. Does such litigation actually occur? If so, in what sorts of circumstances, brought by what sorts of claimants and against whom?

Yes, leading examples of litigation in respect of misstatements to the market are:

(a) Misleading and deceptive conduct

GPG v GIO Australia Holdings Ltd[61]

GPG alleged that it invested in GIO during the period 30 September 1999 and 2 November 1999 on the basis of misleading and deceptive announcement made by GIO to the ASX on 24 September 1999. GPG alleged that the announcement contravened s 12DA of the ASIC Act because it did not adequately disclose GIO's losses in its reinsurance business. When GIO did disclose those losses (on 2 November 1999), GIO's share price fell sharply.

The question therefore was whether the 24 September 1999 announcement was misleading or deceptive (within the meaning of s 12DA of the ASIC Act).

The Court held that GIO's 24 September 1999 statement constituted misleading and deceptive conduct having regard to:

- the terms of the statement;

- what shareholders and the market had been told about provisioning in relation to past reinsurance claims prior to the statement, in particular in August 1999; and

- what GIO knew at the time.

In this regard, the Court stated:

> [101] … The *reasonable reader* would assume that there was no relevant change for the worse in what was to be expected in relation to reinsurance claims from events known to GIO compared with the announcements in August 1999. Put another way, the *reasonable reader* would assume that no further doubt had been cast upon the adequacy of the current provisions on that account. The GIO announcement dealt expressly with the topic of reinsurance. … Furthermore, the announcement expressly dealt with one source of further reinsurance losses, namely, catastrophes in the current year, but omitted any reference to the other source of such losses: the increase in the amount necessary to meet claims from previous events. This carries the clear implication that further losses on that account were not then anticipated. (Italics added)

[61] [2001] FCA 1761.

> [102] The only question is whether GIO had sufficient knowledge of the problem to require a public statement, or warning, of some kind in the context of this announcement. The answer must be yes. The directors of both GIO and AMP had been advised of likely losses with a midpoint in the vicinity of $100 million. The directors of GIO had been told that there certainly would be losses. On 24 September 1999 the Managing Director of AMP told a selected group that losses were expected which, inferentially, were likely to be at least $139 million, and this was confirmed to a similar group by the Chief Financial Officer of AMP on the same day, in the presence of senior executives of GIO. The Schneider/Robinson report of September 1999 had been the subject of close scrutiny by GIO and AMP personnel and advisers. It was based upon actual experience since 30 June 1999. It was expected to form the basis of statements to be made in a prospectus for a rights issue without independent external examination. All of the drafts of the information memorandum recognised that it would be necessary to say something on the topic without having any basis apart from the September Schneider/Robinson report until late in October 1999. The suggestion that losses of the order of $100 million could be absorbed by the existing prudential margin of $225 million is unconvincing. The advice from Ernst & Young (New York) which GIO had received in relation to the August 1999 increase in provisions was that a prudential margin of $225 million was below normal and there is evidence that problems with Australian Prudential Regulatory Authority would have been anticipated if the prudential margin was reduced. The directors of GIO must have assumed that it was likely that any further significant losses would require additional provisions and so go directly to revenue account as a loss. It is no answer to say that the question would be dealt with in the information memorandum to be issued in due course. The shares in GIO were listed on the ASX and traded daily and the announcement immediately and significantly affected the market price of the shares, as would have been anticipated.

The Court held that the statement was misleading and deceptive even though the information in relation to increased reinsurance losses was not information that was, in itself, “certain enough to … warrant disclosure to the market absent any other announcement”:

> [103] … Those assumptions do not however address the relevant issue, namely, the terms of the announcement which was made to the market. … The form of the announcement and the circumstances in which it was made required that reference should have been made to the substance of the Schneider/Robinson report as relayed to the directors of GIO by Geoffrey Thompson, appropriately qualified to reflect the nature of the information. It is not for GPG or the Court to draft such a reference, but no difficulty in doing so was exposed by the evidence (or the submissions) on behalf of GIO. The absence of such a reference rendered the statement misleading and deceptive. I have not overlooked either the fact that premature release of information may cause damage to shareholders or the fact that casting any doubt upon the adequacy of the increased provision so recently announced would be viewed seriously by the market. Having chosen to speak, GIO came under an obligation not to mislead in so doing.

The Court then went on to consider the question of causation. The Court stated that in determining causation, “the misleading conduct need not be the sole or dominant cause of the decision to invest, provided that it played a part in and contributed to the decision”.

Giles J held that, on the evidence, if the statement had been disclosed, it was unlikely that GPG would have invested in GIO:

> [108] … I accept the evidence that each member of the Committee believed that the provision for past reinsurance events was adequate (and perhaps more than adequate) and that he would have been deterred from the investment if the truth had been appropriately disclosed. After all, this is a hypothetical question upon which the evidence of witnesses is admissible but not decisive. I have no doubt that a shrewd investor who understood what had occurred in relation to GIO in 1999 concerning reinsurance losses would have been inclined to steer clear of new investment in GIO shares if there were any warning of further losses on account of reinsurance of past events even if the warning was heavily qualified. Such a warning would cast doubt upon the integrity of the annual accounts and a shadow over the future of the business. Further losses could imperil the whole scheme of arrangement rather than simply the consideration to be received under it. The risks associated with the investment would clearly be perceived to have increased. GPG was, after all, considering a discretionary new investment. It was under no pressure to make this investment as compared with other opportunities.
>
> [109] The misleading conduct continued to affect GPG until it became aware of the announcements of 2, 3 and 4 November 1999. GPG ultimately participated in the scheme. It sold the AMP notes it received as

a consequence on 10 March 2000, crystallising a loss of $8,366,653, not taking into account the contingent instrument which is retained by it.

(b) Continuous disclosure obligations

ASIC v Southcorp Ltd (*No.2*)[62]

This was a proceeding commenced by ASIC. ASIC alleged that Southcorp breached its continuous disclosure obligations under ASX Listing Rule 3.1 by its executive general manager of corporate affairs sending an email to several analysts that: (a) all of Southcorp's 2000 vintage super premium wines were expected to be sold in the 2003 financial year; and (b) the group profit impact of the poor 2000 vintage on the 2003 financial year compared with the previous year was expected to be a negative amount of approximately $30 million. The email (sent on 18 April 2002) conflicted with Southcorp's ASX announcement on 7 June 2000 that the financial impact of the poor 2000 vintage would be spread over five years.

As a result of the email, three of the 11 analysts issued updated reports and between 18 April 2002 and 19 April 2002 (when ASIC halted trading), the share price dropped by approximately 12%. After the halt was lifted, Southcorp issued an ASX profit classification announcement and a media release to the same effect as the email.

The proceedings were ultimately settled, with Southcorp admitting that it had breached ASX Listing Rule 3.1. A declaration of contravention of the continuous disclosure provisions was made, and on ASIC's request a penalty of $100 000 imposed, pursuant to s 1317E.

Kim Riley (In his capacity as Trustee of the KER Trust) v Jubilee Mines Pty Ltd NL[63]

Mr Riley was a former shareholder in Jubilee Mines. He disposed of his fully paid shares shareholding at the end of September 1994 and partly paid shares in July 1995. He alleged that in September 1994 Jubilee Mines failed to disclose to the market the results of inadvertent drilling on a Jubilee tenement which disclosed a major nickel discovery. When the discovery was eventually announced to the market in 1996, Jubilee's share price jumped. He thus alleged that he had received less for his fully paid shares than he would have otherwise received had disclosure been made, and that he would not have sold his partly paid shares in July 1995 but continued to hold them until September 1997 had disclosure been made. The Court found that the nickel discovery was information that was required to be disclosed by ASX Listing Rule 3.1 and the then s 1001 of the Corporations Law (the predecessor to s 674 of the Corporations Act), and made an order for damages in relation to both set of shares.

There was no concern in this case about the gap in time between the sale of the fully paid or partly paid shares and the 1996 announcement to the market. Nor was there any indication from the court that it would not be able to appropriately and sufficiently quantify the plaintiff's loss in respect of either set of shares, or offset potential contingencies by applying a discount rate.

In relation to the fully paid shares, the Court held that if Jubilee Mines had announced its discovery in September 1994, the share price would have been 3 cents higher than the price for which the defendant sold his shares. The court then applied a discount rate of 10% for contingencies, and awarded the plaintiff A$14,000 for this aspect of the claim. In respect of the fully paid shares, the Court held that the evidence established (in the main, the evidence given by the plaintiff himself) that there was a 'real chance' that, had Jubilee Mines disclosed the drilling results in 1994, he would not have sold his shares until September 1997. The court applied a 20% discount rate for contingencies, and awarded a total of A$1,842,000 for this aspect of the claim.

This case does not appear to have been appealed.

[62] (2003) 203 ALR 627, [2003] FCA 1369.

[63] [2006] WASC 199.

Sons of Gwalia Limited (Administrators Appointed) v Margaretic*;[64] *Sons of Gwalia Limited (Subject to Deed of Company Arrangement) v Margaretic[65]

Mr Margaretic is a shareholder in Gwalia, which is in administration. He alleges that Gwalia breached its continuous disclosure obligations under s 674 of the Corporations Act, and engaged in misleading and deceptive conduct in breach of s 52 of the TPA, s 1041H of the Corporations Act, and s 12DA of the ASIC Act by failing to disclose information to the ASX that its 'gold reserves and resources were or were likely to be insufficient to satisfy Gwalia's gold delivery commitments to such an extent that it could not continue as a going concern'. He alleges that by that conduct, he suffered loss and damage (and seeks monetary compensation), having bought 20,000 shares in the company 11 days prior to it going into administration.

The merits of his claim have not yet been finally determined.

In a further action, Mr Margaretic sought a declaration that, by virtue of his claim to monetary compensation, he was entitled to be treated as a creditor of the company. The Federal and Full Federal Courts agreed that he was a creditor, and as such, his claim would rank with other creditors. This decision was recently affirmed by a majority of the High Court.[66] It has been suggested that the decision in this case may lead to increase in proceedings by disgruntled shareholders, and that legislative reform may be necessary to address any potential undesirable implications of this decision.[67]

***Dorajay Pty Limited v Aristocrat Leisure Limited* (*Aristocrat Leisure Class Action*)**, ongoing

The applicant shareholders (including past shareholders at the time of judgement), allege that between 20 September 2002 and 27 May 2003, Aristocrat (by positive statements and silence) made a series of misleading and deceptive representations about its profits for the calendar years 2002 and 2003, and certain aspects of its operations (or its profitability), in contravention of s 1041H of the Corporations Act and s 12DA of the ASIC Act. The applicants also claim that Aristocrat contravened it continuous disclosure obligations under ASX Listing Rule 3.1 and s 674 of the Corporations Act.

There are 682 people in the class, who fall into two categories: '*small claimants*': the 391 persons who claim to have suffered a direct loss of less than $5000; and, '*large claimants*': the 291 persons who claim to have suffered a direct loss of greater than $5000. The loss and damage is said to be the difference between the price at which the group members acquired their interests in the shares and, for those who sold their interest before the date of judgement in the proceedings, the price at which they sold, and for those who have not sold at the date of judgment, the market value at that date.

The case is still in the pre-trial stages (the most recent interlocutory decision being in relation to discovery, and access to documents and litigation funding).

7. Is any form of collective private litigation facilitated by the legal system (for example, class actions)?

---

[64] (2005) 55 ACSR 365 (first instance decision).

[65] [2006] FCAFC 17.

[66] [2007] HCA 1 (31 January 2007), Callinan J dissenting. Full text of the judgement is available at: www.austlii.edu.au/au/cases/cth/HCA/2007/1.html

[67] J Stumbles, Case Notes, (2006) 25 *ARELJ* 90, at pp 95 – 97.

Yes. For instance, Part IVA of the *Federal Court Rules* and most State Supreme Court Rules[68] permit class actions to be taken in accordance with those rules.

The *Aristocrat Class Action* (see above) is an example of a current class action by shareholders under Part IVA of the *Federal Court Rules*. That action is also an example of a class action which is being funded by a litigation funding company. Other examples of class actions include: *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd) ('GIO Class Action')*; *Reiffel v CAN 075 839 226 Ltd* (*Astor Goldsbrough Class Action*') (see point 6, above).

A particular issue in class actions relates to the use of litigation funding arrangements by applicants/ plaintiffs.[69] Proponents assert that litigation funding arrangements facilitate access to justice, whilst opponents contend that they encourage trafficking in litigation. This issue was recently examined by the High Court in *Campbells Cash and Carry Pty Limited v Fostif Pty Limited; Australian Liquor Marketers Pty Limited v Berney* ('*Fostif*').[70]

The *Fostif* litigation was brought by a group of tobacco retailers, to recover licensing fees paid to tobacco wholesalers under the state and territory tobacco licensing schemes declared invalid by the High Court in an earlier decision. The proceedings were brought as 'representative proceedings' under the NSW Supreme Court Rules (now the *Uniform Civil Procedure Rules 2005*). The retailers sought to fund the litigation using a funding company on the basis that it would receive one third of any proceeds of the litigation received by the tobacco retailers, in addition to the befit of any favourable costs order. The tobacco wholesalers argued that third party funding was an abuse of process and/or contrary to public policy. The High Court rejected these arguments saying that in states that have abolished the crimes and torts of maintenance and champerty (as in NSW), no public policy considerations arise in relation to litigation funding; the only question of public policy that may arise is in the enforcement of the litigation funding agreements themselves.

Note that in the *Aristocrat Class Action*, prior to the decision in *Fostif*, Stone J held that the retainer and funding agreements particular to that case were not an abuse of the Court' s process.[71]

8. What is the balance of enforcement as between private litigation and public enforcement via, for example, a securities market regulator or public prosecuting authorities?

The Corporations Act attempts to create a balance between private litigation and public enforcement, though, in practice, such balance may weigh in favour of ASIC given the complexity and resources required to successfully pursue such litigation.

<u>ASIC's power to take civil proceedings on behalf of an investor</u>

Under s 12GM(2)(b) of the ASIC Act, ASIC has power to commence proceedings on behalf of an investor with their consent.[72] ASIC also has power under s 50 of the ASIC Act to commence proceedings against a person following investigation of the alleged defendant pursuant to s 13 of the ASIC Act. Proceedings commenced under s 50 are expressed as being commenced in 'the person's

---

[68] For instance, *Uniform Civil Procedure Rules 2005* (NSW), reg 7.4; under reg 7.4 a proceeding may be commenced and carried on by or against any one or more persons as representing any one or more of them, where they have the same interest or same liability in any proceedings.

[69] See, *Litigation funding in Australia*, Standing Committee of Attorneys-General, Discussion Paper, May 2006. There have been more than 20 court challenges to litigation funding arrangements over the last 8 years.

[70] [2006] HCA 1.

[71] [2005] FCA 1483, at [87].

[72] s 12GM and s 50 (following an investigation under s 13 ASIC Act). Note where the investor is a company, s 50 provides that ASIC may commence proceedings without the investor's consent.

name'. Whilst there has been no judicial consideration of s 50, it would seem that s 50 allows ASIC to take proceedings on behalf of investors. Note that s 50 only requires ASIC to seek the written consent of persons other than corporations before commencing proceedings pursuant to this provision.[73]

ASIC also has power to seek damages for loss suffered by investors in proceedings (defined as 'compensation orders') commenced by ASIC under the Corporations Act.[74]

There are various examples of ASIC commencing proceedings on behalf of investors, or seeking compensation on behalf of investors or creditors as the case may be.[75] Under the heading "Enforcement" in its 2005-06 Annual Report ASIC reports that:

> **Civil action and compensation**
> We obtained compensation, refunds, fines and costs of $144 million, and had assets worth over $71 million frozen for investors and creditors.
>
> ASIC took 102 civil proceedings to stop misconduct, protect assets or obtain remedial or protective orders and fines, with orders against 230 people or companies.

ASIC also has power to bring proceedings under the Corporations Act under s 1324 of the Act, as well as a power to intervene in matters brought under the Act.[76]

However whether ASIC uses its powers depends on its willingness to pursue litigation in a particular matter.[77] In a 2004 Centre for Corporate Law and Securities Regulation research paper on ASIC's enforcement practices,[78] the authors found that ASIC pursue 'litigation as [a] last resort', and generally sought to use other enforcement mechanisms in lieu of litigation.[79]

The research paper concluded that when ASIC does resort to litigation:

---

[73] It is worth setting out s 50 in full:

> **50 ASIC may cause civil proceeding to be begun**
> Where, as a result of an investigation or from a record of an examination (being an investigation or examination conducted under this Part), it appears to ASIC to be in the public interest for a person to begin and carry on a proceeding for:
> (a) the recovery of damages for fraud, negligence, default, breach of duty, or other misconduct, committed in connection with a matter to which the investigation or examination related; or
> (b) recovery of property of the person;
> ASIC:
> (c) if the person is a company--may cause; or
> (d) otherwise--may, with the person's written consent, cause;
> such a proceeding to be begun and carried on in the person's name.

[74] s 1317J Corporations Act; under s 11 of the ASIC Act has such powers and functions as conferred on it under the Corporations Act.

[75] For example, in *ASIC v Adler and 4 Ors* (which arose out of the HIH Insurance Ltd collapse) ASIC successfully sought a compensation order against Mr Adler, the Adler Corporation and Mr Williams (former HIH directors) on behalf of HIH creditors.

[76] s 1330 of the Corporations Act. Note that this power appears to be as of right, rather than by leave of the court.

[77] Golding and Kalfus, at p 408.

[78] Helen Bird, Davin Chow, Jarrod Ienne and Ian Ramsey, *ASIC Enforcement Patterns*, Research Paper No.71, Centre for Corporate Law and Securities Regulation, University of Melbourne (2004) ('ASIC Enforcement Patterns').

[79] This is consistent with ASIC's, *Guide to how we work* booklet at pages 8 and 10, available at www.asic.gov.au ('ASIC Guide to how we work')

- more likely to do so in relation to matters it considers 'serious' breaches, and in respect of laws that are mandatory (rather than enabling) in nature (such as the continuous disclosure obligations); oriented towards social, rather than economic, regulation; or address conduct that is widely condemned because it exploits and defrauds shareholders and creditors.[80] This is consistent with ASIC's stated policy 'to take action when there are serious breaches that threaten the objectives of the law, [and] harm consumers or the integrity of the financial markets'.[81]

- it predominantly uses penal over civil enforcement (and is more likely to settle civil matters), and seeks a limited, severe set of penal sanctions (specifically fines and custodial sentences) despite the availability of a much wider range of sanctions.[82]

The balance between private and public enforcement will also depend on shareholder willingness to bring proceedings (by way of class action or otherwise). The decision in *Forstif* has perhaps created a measure of certainty in relation to the use of litigation funding arrangements to fund class actions, and as such, it is possible that there could be an increase in this type of litigation in the future.[83]

---

[80] Ibid, at p (xiv).

[81] ASIC Guide to how we work, at p 8.

[82] ASIC Enforcement Patterns, at p (xv).

[83] See, in relation to the *Sons of Gwalia* decision, Stumbles, n 67 above.