The Infringement Notice Mechanism and the Australian Continuous Disclosure Regime – Evidence to 2010

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Inadequate disclosure of material information concerning the future and fortunes of listed companies can detract from the integrity of the market and its ability to provide a fair and efficient mechanism for participation in securities markets, while also impacting upon the perceived credibility of financial markets and the corporations constituting them. Reduced confidence in financial markets can in turn have longer-term flow on effects which can be felt throughout the economy. A crucial element of financial market regulation in Australia central to corporate governance and accountability debates is the obligation on listed and other disclosing entities to continuously disclose material information to the market. If, as noted by Golding and Kalfus (2004), 'the vigour of enforcement is the key to the effectiveness of continuous disclosure requirements', then it is important to inquire into the use of different types of enforcement tools. This paper analyses the operation of one of the enforcement tools in ASIC's securities markets toolbox, the infringement notice, focussing on its employment over the last three years to assess whether it is achieving the goals set for it at its inception.

Field of research: Business regulation, accountability

Introduction

According to the 2008 Australian Securities Exchange (ASX) Share Ownership Study, some 6.7 million Australians or 41 per cent of the Australian population own shares either directly or indirectly through superannuation. It is of the utmost importance therefore to ensure the fair and efficient operation of Australian capital markets and the allocation of scarce resources to their best uses. Inadequate disclosure of material information concerning the future and fortunes of listed companies can detract from the integrity of the market and its ability to provide a fair and efficient mechanism for participation in securities markets, while also impacting upon the perceived credibility of financial markets and the corporations constituting them. Reduced confidence in financial markets can in turn have longer-term flow on effects which can be felt throughout the economy.

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A crucial element of financial market regulation in Australia geared towards achieving and maintaining market integrity is the obligation of listed and other disclosing entities to continuously disclose material information to the market. The continuous disclosure obligation is found in Listing Rule 3.1 of the ASX Listing Rules which currently states:

> Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.[i]

If, as argued by Golding and Kalfus (2004), 'the vigour of enforcement is the key to the effectiveness of continuous disclosure requirements'[ii] then it is important to understand the types of situations giving rise to different types of enforcement activity. This paper analyses the operation of one of the enforcement weapons in the arsenal of the Australian Securities and Investments Commission (ASIC), the infringement notice, focussing on its use over the last four years to determine whether its use has lived up to expectations established at the time of its introduction.

The enforcement of the continuous disclosure regime in Australia

While existing until 1994 solely as a listing rule with contractual consequences for breach (for example, suspension or removal from the official list), in 2002, the ASX stated with the benefit of hindsight 'Australia's experience is that, without the legislative support for continuous disclosure and a regulator with an appetite to enforce it, the regime may be perceived as being ineffectual in encouraging compliance'.[iii] The effect of the blending of market operator and legislative enforcement of the regime is that the responsibility for administering the continuous disclosure regime is at the feet of both the (currently) sole market operator, the ASX and the Australian Securities and Investments Commission. While the ASX's role as a market operator listed on its own exchange is relatively technical and is restricted to setting the rules, monitoring trading activity and potential continuous disclosure breaches and engaging in communication with suspect companies before informing ASIC of problematic cases warranting further investigation, there are several layers to the enforcement options available to ASIC which have expanded notably over the last decade and which are worth exploring in understanding the hitherto more frequently used infringement notice.

Failure to comply with Listing rule 3.1 is a criminal offence under s 674(2) for the disclosing entity (s 1311), with the punishment being in the order of 200 penalty units. If directors, officers or advisors aid, abet, counsel or procure the breach by the disclosing entity they may also be found criminally liable. The section was first made a civil penalty provision in 2002 though at the time it only applied to corporations and the maximum pecuniary penalty amount was set at $200,000.

Amendments in 2004 as part of the CLERP 9 Act increased the maximum penalty for corporations from $200,000 to $1 million, and extended civil

liability to persons involved in an organisation's contravention (s 674(2A) and 675(2A)), meaning that civil penalties could be sought against directors and executive officers involved in a contravention of the regime (s 1317E(1) and 1317DA)[iv] including pecuniary penalties of up to $200,000. The reasoning behind this change was that it might act as a more forceful and effective deterrent than financial penalties imposed solely on the entity. Up until the enactment of the CLERP 9 Act in 2004, no criminal prosecutions relating to continuous disclosure breaches had been launched and only three civil penalty applications had been launched between the extension of civil penalty regime to market misconduct provisions including continuous disclosure breaches in 2002 and the introduction of the CLERP 9 Act on 1 July 2004.

The difficulties encountered by ASIC in its policing of the continuous disclosure regime and subsequent requests from ASIC for less cumbersome firepower to be added to its enforcement armoury which could be directed at quickly responding to less serious contraventions of the regime led to the introduction of the infringement notice mechanism. This measure was designed to supplement existing criminal and civil enforcement measures and function as an "on the spot fine" for continuous disclosure breaches. Through s1317DAC ASIC has the power to issue an infringement notice if it has reasonable grounds to believe that a disclosing entity has contravened s674(2) or 675(2). The measure was introduced to remedy a significant gap in the current enforcement framework by facilitating the imposition of a relatively small financial penalty and requiring information disclosure in relation to relatively minor contraventions of the continuous disclosure provisions of the Corporations Act that would not otherwise be pursued through the courts. The capacity to issue an infringement notice also allows ASIC to signal its views concerning appropriate disclosure practices to listed entities more effectively than through court action alone.[v]

It has been said this represents a policy reversal[vi] from an initial position which saw the primary responsibility for enforcing contraventions of the regime as lying squarely on the ASX's shoulders with the support of the legislative backing of the rule, the threat of criminal penalties flowing from which were expected to have preventative force. With the passing of time and legislative review however ASIC has come to play an ever more significant role in the policing of the continuous disclosure regime. The reasons underlying this policy reversal stem from the difficulties in enforcement faced by the ASX and ASIC[vii] whose earlier penalties had an 'all or nothing' character about them (suspension, delisting, criminal sanctions, civil penalties), resulting in a reluctance in their employ, and a resulting lack of faith in the continuous disclosure regime in the face of questionable company disclosure practices.

In its Regulatory Guide 73, ASIC explained that infringement notices were 'designed to provide a fast and effective remedy so that redress is proportionate and proximate in time to the alleged breach. The matter will be dealt with in a timely and efficient way, while still providing significant protection to the disclosing entity'.[viii]

The regulatory guide also sets out 10 steps in the infringement notice process, which begins with an ASIC investigation, and if an infringement notice is deemed appropriate, moves to the briefing of an ASIC delegate who will examine the matter with a fresh set of eyes (not having been involved in initial investigation). If the delegate believes a breach has occurred, a hearing notice is issued to the entity where evidence may be presented, and a hearing is held to determine whether to issue an infringement notice. If reasonable grounds exist for believing a breach has occurred, an infringement notice will be issued served with the entity being given 28 days to comply.

If the notice is complied with, ASIC is not able to begin civil or criminal proceedings against the entity. If it does not comply within this time frame, the entity may seek an extension or seek to have the notice withdrawn (s 1317DAI(1)), or choose not to comply with the notice at all. If it chooses the latter, ASIC faces a tough decision as to whether to commence civil proceedings against the entity under Pt 9.4B and/or s 1324B of the *Corporations Act*, with the maximum civil penalty being $1 million. ASIC can choose to withdraw the notice, and if it does so, it is not restricted in the action it may take against the entity.

Analysis of the circumstances giving rise to the latest infringement notices

The only public information available as far as infringement notices are concerned involves only the entities which have actually complied with one. ASIC publishes details of infringement notices which have been complied with when finalised, presumably keeping with the educative goals of the mechanism. Most companies studied (though not all) also make their own announcement in relation to the payment of the fine. Unfortunately information regarding infringement notices issued but not complied with is, strictly speaking, unavailable. While s 1317DAJ(1) of the *Corporations Act* prohibits ASIC from publicising details of companies who fail to comply with an infringement notice, this has not stopped ASIC revealing its suspicion of Telstra on one occasion, though despite issuing an infringement notice which was not complied with, ASIC chose not to pursue the company.[ix] Nevertheless, there is no real way of knowing whether a company has been issued an infringement notice if it has chosen not to comply with it.

The following analysis highlights the events leading to the issuance of the five most recent infringement notices, and what these add to existing analyses (See Langley, 2007 and Welsh 2007). The table below tracks compliance with infringement notices issued since the introduction of the measure to December 2010.

Infringement Notices complied with 2004 – December 2010

Company	Name	Fine amount	Date finalised	GICS industry group
SBP	Solbec	$33000	1 August 2005	Pharmaceuticals, Biotechnology & Life Sciences
QRS	QRSciences	$33000	17 February 2006	Technology Hardware & Equipment
SDI	SDI	$33000	21 April 2006	Health Care Equipment & Services
AVS	Avastra	$33000	15 May 2006	Pharmaceuticals, Biotechnology & Life Sciences
ATR	Astron	$66000	18 July 2006	Materials
ACU	Avantogen	$33000	8 December 2006	Pharmaceuticals, Biotechnology & Life Sciences
PMN	Promina	$100000	20 March 2007	Insurance
RCA	Raw Capital Partners	$33000	1 August 2007	Software and services
SBS	Sub-Sahara Resources NL	$33000	29 April 2008	Materials
RIO	Rio Tinto	$100000	5 June 2008	Materials
CBA	Commonwealth Bank	$100000	14 October 2009	Financials
CTO	Citigold Corporation	$33000	22 September 2010	Materials

Raw Capital Partners

The eighth company to pay an infringement notice was IT services company Raw Capital Partners (formerly Trysoft Corporation Limited). A significant proportion (approximately 67 per cent) of the company's revenue at the time of the contravention came from a contract with telecommunications giant Optus for the provision of network, server, desktop and application support services. On 30 October 2006, Raw Capital's MD Douglas Wong was informed via telephone that Optus would not be extending this contract beyond February 2007. On 31 October, Mr Wong received an email confirming the same. A reasonable person would have considered this constituted material information worthy of an announcement to the market, given that it would affect a revenue stream of such significance to the company's business. No announcement was forthcoming.

On 22 November ASIC asked the company to produce documents relating to its contract with Optus. Two days later, Raw released an announcement to the ASX stating that Optus would not be renewing their agreement. This constituted the second most flagrant breach of the continuous disclosure provisions warranting an infringement notice from ASIC, given that the company was aware of the said information for 25 days (19 business days) before it decided to inform the market, and even then, after an ASIC query.

Nevertheless, in an ASX announcement dated 1 August 2007, the company announced that it had chosen to comply with the infringement notice as it '[did] not believe that its interests or those of its shareholders [were] best served by a protracted legal dispute with ASIC'. This was in view of the fact that the case could have gone much further had ASIC been prepared to use another harder enforcement mechanism to deal with this breach, as they arguably should have.

In its release dated 1 August 2007, the company further stated that it had rejected ASIC's allegation of contravention, and that it

> carefully considered the information available to it in light of the nature of the discussions, terms of its contract, and the history of previous dealings, with Optus. The Company concluded that, as it was engaged in incomplete discussions with Optus on a range of issues including the nature of its ongoing contract with Optus after 28 February 2007, it was not in a position to make an announcement with a sufficient degree of certainty until an announcement was made on 24 November 2006.

Since payment of the infringement notice is in no way an admission of liability, many companies have used an announcement documenting the payment of the fine to try to absolve themselves of any link to a contravention, as is evident here. However, it would appear that unless there had been a new arrangement with Optus in the pipeline covering most of the shortfall from the termination of the main contract, that the information should have been released regardless.

Indeed, this is in slight conflict with the company's earlier announcement on 24 November 2006 disclosing the information to the market, which gives the impression of a company in relative crisis trying to deal with the loss of a major revenue stream as quickly as possible:

> Trysoft is in negotiations with Optus as to arrangements consequent upon the expected expiry of the Agreement as well as possible alternate support arrangements. However, to date there are no agreed arrangements with respect to commitments beyond the term of the current Agreement and Trysoft will announce any further developments as is appropriate in the circumstances. Trysoft has over recent months been exploring offshore opportunities in China and Asia as a means of accelerating the scale and diversity of its operations. … Trysoft remains confident that current opportunities being investigated and negotiated will provide it with an enhanced and diversified operating base.

Compared to previous conduct raising the ire of the infringement notice, this breach was rather flagrant. This highlights Welsh's point that although the administrative penalty mechanism is supposed to be directed at relatively

minor contraventions as an educational tool, there exist no real restrictions which situations ASIC might choose to issue an infringement notice:

> There is no provision in the Act stating that the regime is to be used to enforce minor contraventions exclusively, nor is there a definition of or any guidance as to what a minor contravention actually is. As there is no provision in the Act limiting the use of the regime to non-serious contraventions of the continuous disclosure provisions and no guidance as to what a non-serious contravention actually is, there is a risk that ASIC may in fact use these provisions to enforce serious contraventions of the continuous disclosure provisions. This could lead to inadequate enforcement of contraventions of the continuous disclosure provisions.[x]

Sub-Sahara Resources NL

The ninth company to pay an infringement notice was Sub-Sahara Resources NL, a junior resources exploration company with interests in Eritrea, Tanzania and Australia. One interest in northern Eritrea called the Zara Gold Project underwent metallurgical testing, the results of which were communicated to the MD progressively from 5 July 2007. Complete attested metallurgical test results confirming the positive results obtained at the Zara project became available to the MD the afternoon of 19 July 2007. While a release to the market was in the process of being drafted, nothing had been announced to the market when on 24 July 2007 the ASX queried a price and volume increase in the trading of the company's securities. A few hours later that day Sub-Sahara made an announcement to the market entitled 'Excellent Gold Recovery From Koka Metallurgical Test' containing the relevant information.

Given the results concerned a significant element of Sub-Sahara's exploration activity and would therefore have a positive effect on Sub-Sahara's shareholders' interests, it constituted information fit for immediate disclosure.

In its 26 July response to an ASX aware letter issued 25 July, the company stated that prior to the announcement made 24 July the only people to have known the results of the metallurgical tests were the company's secretary and directors. As for why it waited to release the information from 19 to 24 July (3.5 business days) the company explained that due to the technical nature of the results, internal experts needed to be consulted to ensure the accuracy of any potential announcement to the market to prevent the release of misleading information. The company took a further day (Monday 23 July) to seek the opinion of its joint venture partners, one of whom replied on Tuesday 24, the company stating in its 26 July response to the ASX aware letter that 'the Company received the ASX query on Tuesday 24 July 2007, it was already in the process of finalising the draft ASX announcement for release'.

On 21 April Sub-Sahara informed the ASX that it intended to fully comply with the infringement notice issued by ASIC, reminding investors that compliance was not an admission of liability and could not be regarded as a finding that

Sub-Sahara had contravened the *Corporations Act*. The run-up in the price of the company's securities apparent between 19 and 24 July indicating that confidentiality may have been lost may have influenced ASIC in making its final decision to issue the infringement notice, for it seems the company's reasoning would have allowed it the space to argue for the application of the exemption provisions. The company did not try to defend its conduct in the same manner as Raw Capital.

Rio Tinto Limited

The second company with a market capitalisation of over $1000 million and the tenth to pay an infringement notice was Rio Tinto Limited in June 2008. The alleged contravention related to the takeover of Canadian aluminium company Alcan. At the final stages of the confidential negotiation process, Rio made an offer on 10 July 2007, for which it received unanimous acceptance from the Board of Alcan the morning of 12 July 2007.

At 2.30pm that day Dow Jones Newswires published an article entitled 'Rio Tinto Nears Deal to Acquire Alcan of Canada' which stated

> Rio Tinto was last night in the closing stages of a deal to purchase Canadian aluminium giant Alcan Inc. to help the Canadian aluminium giant stave off a hostile bid from Alcoa Inc., according to people familiar with the transaction. A final deal should be announced early today, these people said, and was expected to carry an all-cash price tag approaching $100 a share, valuing the deal at about $37 billion.

This information was considered by ASIC to be reasonably specific given the actual terms of the bid agreed upon, meaning that the information had effectively ceased to be confidential, and that any protection offered by the listing rule exceptions had also ceased. Two further newswire articles were released soon after the first containing similar information.[xi] After a call from the ASX at 3.00pm that afternoon, Rio requested a trading halt at 3.38pm. At about 4.00pm, Rio formally announced its offer and Alcan's acceptance. ASIC alleged that Rio was in breach of its obligations from the time of the release of the first newswire by Dow Jones until it requested the trading halt.

ASIC was of the opinion that at 2.30pm the confidentiality of negotiations had been lost and stated in its release dated 5 June 2008 that

> in view of the speculation about the Offer in the Dow Jones article and in the absence of an immediate request by Rio Tinto for a trading halt under ASX Listing Rule 16.4.2, a reasonable person would have expected the Information to be disclosed to ASX.

ASIC considered the information of such a nature that it would have a material effect upon the value and/or price of Rio's securities if generally available due to the fact that the takeover would be value accretive for shareholders and

also that the price offered represented significant premium on the market price of Alcan shares. This argument to be sure is faultless. A takeover of this magnitude Alan Kohler, 'Continuous Dysfunction', *Business Spectator* (online), 15 February 2008 at the price offered would no doubt constitute important information for a reasonable person.

But I'll see ASIC's reasonable person and raise them 'my more reasonable person' (Kohler, 2008)[xii] and ask — was the information in the newswire such that a reasonable investor would rely on its veracity and make a serious decision on the basis of it? If so, and the speculation turned out to be incorrect, the investor would have to wear their decision. While it may have seemed clear to ASIC that continuous disclosure provisions were breached, it is not so clear given that the report itself was speculative that they affected the market in any way more than any other news report in the days or months proceeding the event may have. At the very least, despite its leviathan proportions, one can sympathise with Rio's position at the time in ensuring the deal was effectively complete.

In its response dated 16 July to the ASX aware letter sent 12 July, Rio emphasised that negotiations were governed by a confidentiality agreement, and also drew attention to the fact that media speculation at the time revolved around a number of other bidders, and that the target Alcan had 'confirmed that it was in discussions with a number of possible "white knight" bidders and was conducting an auction process'.

In its explanation in the same release as to why it did not release the information to the market or request a trading halt earlier, Rio stated that although it had been advised it was the preferred bidder the morning of 12 July, that this was 'subject to final negotiation and agreement on the transaction documents … Negotiation of terms, including in relation to the financing, continued in Montreal throughout Thursday (Melbourne time) and, because of the competitive nature of the process, there remained the real possibility that a transaction would not proceed'. ASIC's opinion after the fact was that this was irrelevant — as in the case of Promina which also concerned a takeover offer — given that information in the public domain containing reasonably specific and reasonably accurate information was available and might create informed pockets in an otherwise uninformed market.

It appears that after conversations with ASIC that morning, it was decided Rio should not request a trading halt or make an announcement as the deal had not been finalised and confidentiality remained intact. Rio's release gives an interesting insight into the management of its continuous disclosure obligation — it states that market trading and media reports were monitored during the progress of negotiations in Montreal that day, and that Rio had discussed the issue again with ASIC at 3.20pm that afternoon and at a further internal meeting where the takeover and the media reports were discussed. Through these discussions, Rio had

> confirmed that there had not been any material change in the price of Rio Tinto Limited securities on the ASX or any abnormal trading volumes throughout the day. This continued to support the conclusion that confidentiality had not been lost, notwithstanding the increased speculation in the media. However, based on further advice received from those involved in the transaction negotiations in Montreal, the view was formed that the transaction had progressed sufficiently so that an announcement of a completed transaction was imminent. Given that, a call was made to you and the trading halt initiated.

It took ASIC close to nine months to issue its infringement notice to Rio, and a further two months for the company to agree to paying the penalty, which a spokesman stated was a decision made with the hope of putting the issue to rest front of mind: 'We want to put this matter behind us … The issues raised by this case require a fine judgment and we have nothing further to say'.[xiii]

This infringement notice seems a little on the harsh side of ASIC's discretion — the information released in the newswire according to Rio should have been viewed with other reports released at the time which referred to another bidder for Alcan. Trading volumes were in line with volumes traded in the preceeding weeks and the highest price for the day was a mere 2.1 per cent higher than the opening price. Rio was left in an interesting position — pay a paltry $100,000 fine (this is one of Australia's largest companies) or call in the lawyers to contest the fine for what would probably amount to more than that. The decision is a relatively easy one, though compliance alone does not tell the full story as the situation itself lies at the borders of acceptable disclosure practices. This certainly did not have the same element of flagrant abuse of the regime that the Raw Capital situation demonstrates, though it may be more what ASIC was originally looking at using the infringement notice for — a breach strictly speaking, though on the relatively less serious side.

Commonwealth Bank of Australia (CBA)

The 11th and most recent infringement notice was issued to another of Australia's largest companies, the Commonwealth Bank. The notice related to information concerning the bank's loan impairment expense as a result of its exposure to organisations caught up in the global financial crisis. On 13 November 2008, CBA released an announcement stating that its exposure to the collapse of Lehman Brothers, Allco Finance Group Limited and ABC Learning Centres Limited would result in significantly higher first half provisions for loan impairment which was now expected to be between 40 and 50 basis points.

A month later on December 10 CBA announced that it had entered into a placement agreement with Merrill Lynch to raise $750 million of new capital. Just 6 days later CBA announced that it had completed a $2 billion capital raising through a combination of an institutional placement in addition to the existing arrangement with Merrill Lynch. While the initial offer raised $357 million at a price of $28.37 per share, the institutional placement was made at

a price of $27 (a 5% discount) and was also initially managed by Merrill Lynch, which confidentially sounded out major CBA shareholders that afternoon to gauge interest in the placement.

ASIC alleged that at 3.00pm that afternoon, CBA became aware of its projected loan impairment expense for 2009, which would equate to about 61 basis points. This information was then passed on to Merrill Lynch an hour later in the form of a draft media release. Once the soundings were completed, CBA released an announcement to the ASX around 7pm that evening in which it announced it had completed a $2 billion capital raising. It also used the opportunity to advise that the full year loan impairment expense was now expected to be around 60 basis points.

On 18 December, after receiving an ASX aware letter, CBA released another announcement in which it spelt out the impact of its impairment expense on its bottom line, comparing the effect of a 60 basis points for impairment expenses at approximately $2.5 billion with its previously advised figures of 40 to 50 basis points, which would approximate a $1.7–$2.1 billion drop in net profit. ASIC noted in its press release that this could have constituted a drop in net profit of between 5 and 7 per cent, and that in the economic climate at the time, 'there was a heightened interest in the market regarding impairment of bank loan assets and bank profitability', especially in the context of conducting a capital raising that day. In view of the fact that this translated into an increase in the order of $600 million over its previously advised (13 November) expected loan impairment expense, the information constituted material information which CBA should have released when it became aware of it.

Despite the fact CBA had forwarded the information to Merrill Lynch, it apparently had not been passed on in the confidential soundings undertaken. Indeed, since the information was material, it should have been released to the market at the same time. The bank's CEO Ralph Norris stated in the company's press release dated 14 October 2009 that the bank was disappointed with ASIC's decision to issue the infringement notice on the basis that impairment expense constitutes 'a single line item in the Group's profit and loss statement and should not be considered in isolation'. Norris also stated that the bank was experiencing strong volume and revenue growth which was expected to offset the increase in impairment expense, making the increase immaterial. If this was the case, why then did the bank feel it necessary at the time to release the information to potential institutional subscribers, given that full year profit figures would not change materially on balance from those projected 13 November? Despite the fact that '[t]he new loan loss estimate flowed from work on general provisioning, the least precise element in loan loss estimates … institutions were angry they had not been told about the increase in the loan loss provisioning'.[xiv] Furthermore, if this was the case how could CBA explain its termination of the Merrill Lynch placement and the retention of UBS to complete another placement the next day at a significant discount to the completed Merrill Lynch deal? As stated by Frith, 'CBA's actions were not consistent with a belief the blowout was not a material issue'.[xv]

ASIC was seen by some as taking a tough line, though this does not seem as tough as the line drawn for Rio. It has been said that the underlying issue is that the bank thought it 'important enough to tell investors about to buy stock in an off-market placement, but not important enough to tell investors buying stock on the market. There was only an hour in it but CBA was trying to manage its continuous disclosure obligations to fit in with the capital raising. Its priorities should have been the other way around'.[xvi]

Nevertheless, the CBA Board stood behind its captains, stating they had its full support and that 'at all times the bank was acting in the interests of shareholders'.[xvii] This seems to mean existing as opposed to prospective shareholders (including those involved in the initial capital raising which secured $357 million) who, as Drummond notes above, were not privy to this information when securities were trading at a premium to the $27 priced institutional placement.

Citigold Corporation (CTO)

The most recent infringement notice issued was to gold miner Citigold Corporation which was finalised in September 2010. It was issued by ASIC 19 August 2010 for the company's failure to inform the market of changes to its gold production targets in December 2009. In an extract from the infringement notice ASIC cited several instances of Citigold's confirmation of production forecasts during 2009 for the December 2009 quarter and the 2010 calendar year, the latest provided 16 November 2009, where shareholders at the company's AGM 'were told that Citigold was on target to achieve its forecast gold production targets'.[xviii] The relevant forecasts were for 15,000 ounces of gold production in the December quarter 2009 and 85,000 ounces for the 2010 Calendar Year.

On 16 December Citigold released an announcement providing revised production targets for its Charters Towers mining operation. In it the company advised that the expected gold production for the December quarter had dropped to 5000 ounces, and that the company had revised its full year 2010 forecast down to 50,000 ounces. Despite its best efforts to spin these changes into positive sentiments in its 16 December announcement, the company received an aware letter from the ASX on 21 December.

In its response to the letter Citigold stated that it had first become aware of the possibility of a drop in production forecasts on 1 December 2009 when the Chief Operating Officer advised directors that production may be lower than forecast for December but that more time was needed to confirm this. ASIC alleged that on 11 December 2009 the CEO and CFO of Citigold were made aware that a review had been completed and that gold production was now expected to be 5,000 ounces for the December 2009 quarter. This represented significant information as the downgrades were substantial – from 15,000 to 5,000 ounces and 85,000 to 50,000 ounces for the December quarter 2009 and the 2010 calendar year respectively. Citigold was therefore found by ASIC to have been in breach of its obligations from 11 December to

16 December (4 business days) as a reasonable person would have expected the information to be released immediately and none of the exceptions applied.

While Citigold has not commented on its payment of the fine, in its response to the ASX aware letter dated 23 December 2009 it stated that it thought the drop in December quarter 2009 production 'has little, if any, impact on the value of the asset and the future growth plans of the company'. The company viewed the revisions as immaterial in view of its planned production targets in future years of more than ten times calendar 2009 output (300,000 vs 25,000 ounces), the life of the mine, and the continuing development and ramp up of the mine. Investors do not seem to have been of the same opinion, with over 10 million shares being traded the day of the announcement. While Citigold's arguments make sense if taking a longer term perspective on the company's prospects it constitutes no less of a breach of the continuous disclosure requirements as the revisions were substantial when compared with previous guidance, which had been reaffirmed several times throughout the year.

General empirical observations

Collecting each instance of infringement notice issuance together it is possible to conduct simple empirical analyses to gain a more generalised picture of the operation of the mechanism in the Australian market. This allows the development of tentative (given there are only 12 companies in the sample) or provisional insights into the types of companies involved in continuous disclosure breaches, whether breaches involved positive or negative news events and ASIC's response times to alleged breaches.

Company size

As at December 2010, $630,000 has been paid to ASIC in satisfaction of infringement notices. Of this figure, $264,000 has been paid by eight of the smaller companies in the enforcement penalty hierarchy with a market capitalisation below $100 million, while there has only been one $66,000 fine for a mid-tier company with a market cap above $100 million. The remaining $300,000 has been paid by three of Australia's largest organisations with market capitalisations exceeding $1000 million. While in absolute terms the larger companies have forked out more in infringement notice penalties due to the higher quantum of penalty, smaller companies seem somewhat disproportionately represented with eight of the 12 (66 per cent) companies fined being Tier 3 companies with a market capitalisation under $100 million.

Langley (2007) found that smaller companies had a greater propensity for non-disclosure — 71 per cent of companies in the seven-company sample available at the time had a market capitalisation below $100 million when fined. The reason posited for this was that 'effective implementation of continuous disclosure programs [at smaller companies] would seem to be less successful than in large publicly-listed companies'.[xix] Despite ASIC having built a reputation early on for chasing the minnows rather than the big guns, a closer look at the Australian market shows this may not be the case. Of the

1924 securities listed on the ASX at the time of writing, only 166 have a market capitalisation in excess of $1000 million, 368 fall between $100 and $1000 million, while the overwhelming majority, 1390 or 72 per cent, of companies have a market cap below $100 million. While the infringement notice data set is extremely small at present, at this stage ASIC's fining of smaller companies seems consistent with market capitalisation. Indeed, due to recent infringement activity, it seems the opposite might be said — that ASIC is chasing the big guns since 25 per cent of fines have been issued to companies with market capitalisations over $100 million despite the fact they only represent 8 per cent of the market. Again, the available data set is not really conducive to any reliable generalisation on this question, but it is interesting nonetheless given previous conjectures concerning ASIC's fining tendencies. In relation to Langley's hypothesis that smaller companies might not have established the systems around effective continuous disclosure compliance leading to their having poor disclosure performance and being fined, which practically speaking may be no less true, the breakdown of companies constituting the Australian market suggests this may simply be due to the fact there are just more smaller companies around to be inadequately dealing with their continuous disclosure obligations.

Industry group

On the basis of ASIC's identification of speculative sectors as 'being most at risk of non-disclosure' Langley found supporting evidence in the fact that '[d]isclosure issues have generally arisen from entities operating in speculative industries, like mining, energy, pharmaceuticals and biotechnology'.[xx] As at the end of 2009, a total of three Pharmaceuticals, Biotechnology & Life Sciences companies, four Materials companies, one Technology Hardware and Equipment company, one Software and Services company, one Health Care Equipment & Services company, one Insurer and one Financial company have been issued infringement notices. ASIC's prediction concerning speculative 'sectors' has explained seven out of the 12 infringement notices issued to companies in the mining and biotechnology sectors. Despite this, however, not all of those companies could readily be classed as 'speculative' securities as such. Further, the presence of institutions from sectors not usually regarded as being speculative including insurance and banking is cause for concern, especially in view of the fact they were also amongst the largest companies to have received an infringement notice, who presumably have the resources to deal with such issues.

Positive versus negative news events

At the time of Langley's analysis '[a]lmost all of the infringement notices related to the failure to disclose material information that would reflect negatively on share price'[xxi], the only clear exception at that stage for Langley being Astron. In the company sample of 12, a total of nine had failed to disclose bad news and three failed to disclose what would ordinarily be considered positive news to the market. Astron should be joined by Promina, whose contravention surrounded its being the subject of a takeover bid (the trajectory of its share price after the offer supporting the conclusion this was indeed a good news event), and Sub-Sahara Resources, which failed to inform the market of revised upward estimates of gold quantities at its Eritrean mines. The lesson from this data is that while many instances resulting in the issuing of an infringement notice involve circumstances where companies might prefer not to release negative information, or at least to sit on it for a while before releasing it, that the practice of withholding positive information is effectively of the same nature as far as the provisions are concerned. This indicates also the difficulties of converting management from a 'compliance' to a 'disclosure' centric information management approach.

ASIC response times

Another important issue surrounds the proximity of ASIC's enforcement action to the breach of the regime. As noted above, the infringement notice regime was designed to avail ASIC of a speedier tool through which to educate the market and effectively process and police contraventions as soon as possible in a bid to assuage any loss in confidence in the integrity of the market. While ASIC's stated goal was to issue infringement notices within three months of the alleged breach (though it has a maximum period of 12 months in which to do so (1317DAC(5))[xxii], Langley found that 'the average time for ASIC to issue an infringement notice from the date of the alleged breach is between seven and eight months, but the time period appears to be improving'.[xxiii]

The evidence from the 12 infringement notices issued to date illustrates that this average has remained constant with the addition of the most recent infringement notices issued, with an average of eight months from the date the company became aware and the date the infringement notice was issued (not including SDI and CBA). While there was a period of improvement when Promina was fined, since then ASIC's response time has been running at eight and a half months, though this does not include the fine issued to the Commonwealth Bank as there is no extant information as to the date the infringement notice was issued. To date, the longest amount of time taken to issue an infringement notice has been 11 months and 23 days in relation to Avastra, while the shortest has been four months and 11 days (Promina).

Conclusions

It appears that the infringement notice regime is functioning as it ever was, not necessarily as it was intended to. ASIC response times (the CBA and SDI examples for which there is no infringement notice date aside) are extremely

slow and have never really come close to the three months expected when the mechanism was introduced. This may steal away some of the force held by this powerful administrative mechanism in protecting the integrity of Australian financial markets, driving the development of solid corporate governance practices, and encouraging accountability to organisational stakeholders.

ASIC has shaken off an early reputation for going after smaller companies by recently taking three large scalps, with two being amongst the top 10 companies in terms of capitalisation in the Australian market, potentially providing important educative examples to the rest of the market. It is interesting to note that at least three of the 12 notices issued concerned information of a positive nature which was not disclosed.

Nevertheless, analysis of recent instances above demonstrates both the lower boundaries of the enforcement of the rule (Rio Tinto) and those circumstances where harsher enforcement action should perhaps have been taken (Raw Capital). This use of the infringement notice instead of potentially softer (enforceable undertakings) or harsher (civil penalty provisions or criminal penalties) enforcement action as the case may be is a tendency which should be monitored. Nevertheless, ASIC's fining activity does send out the message that information management is of serious importance and that companies must discharge their disclosure obligations with continuous disclosure obligations front of mind.

Endotes

[i] Supplemented by Chapter 6CA of the Corporations Act (sections 674-678) and available at http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf .

[ii] Greg Golding and Natalie Kalfus, 'The Continuous Evolution of Australia's Continuous Disclosure Laws' (2004) 22 *Company and Securities Law Journal* 385, 425.

[iii] *Continuous Disclosure — The Australian Experience* (February 2002) 4. Available at http://203.15.147.66/about/pdf/Continuousdisclosure-TheAustExperience.pdf

[iv] A person deemed 'involved' in the contravention can escape liability if they took all steps reasonable in the circumstances to ensure compliance by the entity, and believed on reasonable grounds that the entity had indeed complied with its obligations.

[v] Parliamentary Joint Committee on Corporations and Financial Services, CLERP (Audit Reform and Disclosure) Bill 2003 (Part 1, 2004), 6.27 quoting *Corporate Disclosure: Strengthening the Financial Reporting Framework* (Commonwealth of Australia, 2002) 149.

[vi] HAJ Ford, RP Austin and IM Ramsay, above n 8, 627.

[vii] See further Golding and Kalfus, above n 2, 409.

[viii] Australian Securities and Investments Commission, *Regulatory Guide 73 — Continuous Disclosure Obligations: Infringement Notices* (2004) 4. Available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/infringement_notice_guidelines.pdf/$file/infringement_notice_guidelines.pdf.

[ix] Senate Estimates Committee hearing on 16 February 2006 available at http://www.aph.gov.au/hansard/senate/committee/S9100.pdf .

[x] Michelle Welsh, 'Enforcing Contraventions of the Continuous Disclosure Provisions: Civil or Administrative Penalties' (2007) 25 *Company and Securities Law Journal* 315, 316.

[xi] At 2.41 pm on 12 July 2007, Dow Jones Newswires published a second article titled, '*Rio Tinto Close to US$37b Alcan Deal*', and at 2.46 pm, Reuters published an article titled '*Rio Tinto Near Deal to Buy Alcan*'. Both of these articles contained similar information to the Dow Jones Article.

[xii] Alan Kohler, 'Continuous Dysfunction', *Business Spectator* (online), 15 February 2008 <http://www.businessspectator.com.au/bs.nsf/Article/Continuous-dysfunction-BU3NF?OpenDocument>
[xiii] Quoted in Kevin Andrusiak, 'Rio Pays $100,000 for Alcan Disclosure', *The Australian* (Sydney), 6 June 2008, 25.
[xiv] Malcolm Maiden, 'Botched Placement Shows Intensity of Pressure on CBA', *Australian Financial Review* (Sydney),15 October 2009.
[xv] Bryan Frith, 'CBA Trying to Defend the Indefensible', *The Australian* (Sydney), 15 October 2009.
[xvi] Matthew Drummond, 'One Hour Created Two Classes of Investors', *Australian Financial Review* (Sydney), 15 October 2009.
[xvii] Richard Gluyas, 'Bank Reviews its Botched Raising', *The Australian* (Sydney), 12 February 2009.
[xviii] Extract of the infringement notice available through the link at http://www.asic.gov.au/asic/asic.nsf/byheadline/10-198AD+Citigold+Corporation+pays+$33,000+penalty?openDocument or directly at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Citigold-Notice-Extract-20100921.pdf/$file/Citigold-Notice-Extract-20100921.pdf, p2.
[xix] Langley, above n 17, 453.
[xx] Langley, above n 17, 454.
[xxi] Langley, above n 17, 454.
[xxii] Australian Securities and Investments Commission, *Regulatory Guide 73*, 5.
[xxiii] Langley, above n 17, 457.

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