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BY EMAIL

Dear Mr Lewis

Submission on proposed revised Guidance Note 8

The ASX is to be commended for its work in producing comprehensive revised guidance on Listing Rules 3.1-3.1B (for ease of reference, **GN8**). It should promote improved understanding by all listed companies and their advisers of the ambit of, and the complexities involved in compliance with, the continuous disclosure obligation.

Introductory observations

Clearly guidance even as comprehensive as GN8 cannot say what the answer should be in all disclosure scenarios. GN8 acknowledges that 'assessing how the market will react to particular information is not always easy',[1] but notes that this difficulty is 'inescapable':[2]

> 'It is the entity, and only the entity, that can and must form a view as to whether the information it knows, and the rest of the market does not, is market sensitive and therefore needs to be disclosed under Listing Rule 3.1.'

Of course, the directors'[3] judgment is not conclusive in determining the entity's compliance with its continuous disclosure obligation, given the test of whether information is required to be disclosed is objective. However, GN8's recognition of the complexities which can be involved, and the inescapable need for the directors to make a judgment on behalf of the entity, should give directors some confidence that the ASX and ASIC and ultimately the courts will place due weight on their process of reasoning and judgment.

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1 GN8 page 9 footnote 16. How the market will react is not in fact the test to establish the materiality of information – see below – but the point that disclosure decisions can be difficult is well made.

2 GN8 section 3.2 page 9.

3 In this letter the term 'director' should be taken to include 'officer'.

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GN8 should also serve to better inform the financial media and the market generally, to promote greater understanding that the continuous disclosure obligation does not mean that the market can assume it has perfect information at all times. This is an important additional function of ASX guidance such as GN8, that is, to narrow any expectation gap which could lead to unjustified criticism of entities and unwarranted calls for enforcement action putting pressure on the ASX and ASIC.

Suggested enhancements

There are some aspects of the proposed new guidance (for ease of reference, GN8) which we believe should be further refined to better assist companies to comply with their continuous disclosure obligations and to more effectively narrow any expectation gap. These are noted below.

The test of materiality

GN8 suggests that directors apply a two-limbed test to assist in determining whether information is material.[4] The first limb is: 'Would this information influence my decision to buy or sell securities in the entity at their current market price?'

This is a useful question to ask in that, whilst the test of materiality is objective, as a practical matter directors need to form a view and this is clearly recognised by this limb of the suggested test. Directors may take some comfort that a court will have regard to GN8's recognition and give some weight to the directors' view in determining whether a matter should have been disclosed.

The second limb of GN8's suggested test is: 'Would I feel exposed to an action for insider trading if I were to buy or sell securities in the entity at their current market price, knowing this information had not been disclosed to the market?'

We submit that this simplified application of the insider trading criterion is inappropriate for two reasons.

Firstly, the test of materiality is different to that applicable under Listing Rule 3.1, which as section 3.2 of GN8 makes clear refers to influence in buy or sell decisions on persons who commonly 'invest' being (in effect) value investors rather than short term traders. Under s1042D, the question is whether the information would influence persons who commonly 'acquire' financial products, rather than those who commonly 'invest'. The s1042D test may potentially include (for example) speculative traders and short sellers. It may well be that information which would not influence a value investor would influence a short term trader.

Secondly, it is one thing to ask (as is suggested by the first limb of the test) whether someone would be influenced to buy or sell if they knew everything that the directors know. It is another to consider the prospect that directors, knowing everything they know, might trade shares with someone who knows nothing of what the directors know. Most directors would baulk at the prospect of trading in shares during a black out period under their share trading policy, precisely because of the uncertainty as to how the information they know of outside the trading windows will be defined and characterised.

GN8 does not as such suggest that if this second limb of the suggested test is satisfied, the information is necessarily required to be disclosed. We submit that this should be made clearer in section 3.2. It is a test of sorts but it is by no means conclusive on the question of

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[4] GN8 section 3.2 page 9.

whether disclosure is required and may lead to the directors disclosing information prematurely.

Erring on the side of caution

A clear message of GN8 is that directors should favour disclosure over non-disclosure. GN8 suggests twice that directors should 'err on the side of caution'[5] and if in any doubt, disclose.

One can appreciate the ASX's urge to promote market integrity; however, the directors often have competing duties. In fact the continuous disclosure obligation is particularly susceptible to the potential to create a conflict of duty for directors.

Any business is likely to face potentially serious problems from time to time. The directors have a duty under s180 of the Corporations Act (and under general law fiduciary principles) to act with care and diligence in managing potential problems to seek to prevent them being realised.

Pursuant to s674 of the Corporations Act, ASX Listing Rule 3.1 may require the directors to disclose a potentially serious problem to the market, given the likely effect of the problem on the price of the entity's securities if the market becomes aware of it.

But what if the disclosure of the potential problem will make an otherwise likely manageable potential problem unmanageable? Existing shareholders will suffer a loss of value which may never have occurred if the directors had not disclosed the potential problem and had got on with properly managing it.

The directors' owe their duties to the entity – in effect, the existing security holders – and those duties demand that if a potential problem would become unmanageable if disclosed, it should not be disclosed unless and until the potential is realised. However, since the potential problem would have a negative price impact if generally known, the directors are obliged to disclose it, thus in effect preferring the interests of potential security holders – to whom the directors owe no duty – to the existing security holders – to whom they do owe their duties.

Directors could not be considered in breach of their duty of care and diligence by disclosing a problem if disclosure is required. Directors may however be exposed if they 'err on the side of caution' when disclosure is not in fact required.

We submit that GN8 should acknowledge the potential for directors to have a conflict of duty in some circumstances, such that the advice that they should 'err' in favour of the market's interests over their existing security holders may not always be appropriate.

Example H1

The directors' dilemma is at its starkest when the directors become aware of a potentially (not yet actual) serious problem which arises for their entity's business, although the directors consider that the potential should be able to be overcome – but only if it is not disclosed.

GN8 provides a relevant 'worked example' in Appendix A section H1 (**Example H1**). The entity breaches a financial ratio in its main debt facility because of a temporary factor. The directors 'reasonably believe' that the breach will be waived without penalty. However the directors, being 'prudent and risk averse', decide to disclose the breach and their expectation that it will be waived. After a month of 'delicate negotiations', the banks demand that half the

[5] GN8 sections 3.2 and 3.7.

debt be repaid. This development is announced and the entity also announces a capital raising. The entity's security price is trashed.

Example H1 suggests that an early announcement would be preferable to the directors simply getting on with obtaining the waiver, because of the risk that the waiver will not be obtained and the entity and its directors may be sued.

Example H1 is however somewhat unrealistic, in that the circumstances in the scenario described are likely to be much more nuanced. For a start, it would probably be unlikely that the entity could adequately (or at all) convey in an ASX announcement the full bases for its confidence that a waiver will be obtained, either as a practical matter (given the volume of words that would likely be needed) or as a commercial matter. For example, it is scarcely likely that the entity would not make contact with the bank to get an initial read on the banks' likely attitude, but the banks would never consent to being quoted in an ASX announcement. The directors may be aware of particular commercial drivers within the banks which clearly suggest that the banks are most unlikely to rely on the breach – but such considerations if disclosed could fundamentally damage the relationship with the banks and hence the prospect of the waiver. One can imagine that all the directors could say publicly is that they reasonably believe that a waiver will be obtained. The market may well be unwilling to proceed with blind faith in the directors' belief. If so the security price would be trashed upon the first announcement, rather than the second.

The 'worked example' also posits that the entity is silent until the announcement, after a month of 'delicate negotiations', that the banks want half their money back. But we query whether an entity could avoid saying anything about the negotiations for a month. Conceivably the ASX takes the view that the negotiations would fall within the Listing Rule 3.1A exception, but whilst there is a negotiation and it is incomplete, the fact that there is a negotiation is not confidential and probably a reasonable person would expect disclosure of the progress of the negotiation and the likely terms which may be expected to be imposed – bearing in mind that the ASX proposes to include a definition of 'information' which is based on the insider trading definition, which includes 'matters relating to the intentions, or likely intentions, of a person' (in this case the banks).

Example H1 is of course just an hypothetical 'worked example', but one might imagine that the loss of market confidence in the entity resulting from its premature announcement of the covenant breach, and the conduct of the negotiation effectively in public, turned what should have been a straightforward waiver request into a demand by the banks for half their money back. The directors may escape liability for a continuous disclosure breach but they have unnecessarily destroyed shareholder value.

We submit that Example H1 should be reconsidered in light of the above comments before GN8 is finalised.

The ambit of 'the information'

Example H1 includes a discussion of what would happen if the directors do not disclose the covenant breach until the banks demand half their money back. It suggests that shareholders may well have claims against the entity and the directors under s674. However it is noted that the directors may be able to rely on the 'due diligence' defence in s674(2A) if they can show that they took all reasonable steps to ensure the entity's compliance with its continuous disclosure obligations and, after doing so, believed on reasonable grounds that the entity was complying.

The potential availability of the 'due diligence' defence is clear, but in the scenario described in Example H1 it may well be that the information is not material in the first place.

It was established by the main authority to date on Listing Rule 3.1 and s674, *Jubilee Mines NL v Riley*,[6] that 'information' for this purpose includes all relevant matters of fact, opinion and intention of which the entity is aware. In essence, the opinions and beliefs of the entity form part of the full matrix of relevant information.

In addition, in the *ASIC v Fortescue* decision at first instance,[7] Gilmour J considered that the question of whether the framework agreements were material and hence announceable under s674 depended on Fortescue's belief as to their effect. Gilmour J found that Fortescue genuinely believed the agreements were binding, and had reasonable grounds for that belief, so the agreements were material and it was hence appropriate for Fortescue to announce them. In other words (not Gilmour J's), the information to be assessed for materiality is the information in the eye of the beholder, the beholder being the entity concerned. This approach was essentially supported by Heydon J's decision in the High Court who said:[8] 'Low though ASIC's esteem was for the agreements, if Fortescue had said nothing about them it would probably have been in breach of the ASX listing rules.' Heydon J, like Gilmour J, accepted that Fortescue genuinely and reasonably believed that the agreements were binding. Hence Fortescue's belief (as to the binding effect of the agreements) formed part of the information of which was aware and which made the information (the entry into the agreements) material.

If, as posited in Example H1, the directors 'reasonably believe' that the waiver will be obtained, then that belief and the bases for it form part of 'the information' to be assessed for materiality. On that basis the information (as a whole) described in Example H1 would not cause an investor to sell (or buy obviously). This is consistent with GN8's recognition (in section 3.3) that information needs to be assessed in its context. We submit that Example H1 should more clearly recognise this possible characterisation of 'the information'.

'Immediate' disclosure and trading halts

GN8 makes clear that 'immediately' does not mean 'instantaneously' but rather 'promptly and without delay'.[9] But the extent of promptness required will remain to be determined by the ASX based on its assessment of all the circumstances. As that determination will be made after the event, we submit that GN8 should make clear that the ASX will put itself in the position of the entity at the time (thus to avoid succumbing to hindsight bias).

GN8 notes that trading halts can be used where there is to be delay in getting an announcement out. The ASX encourages the use of trading halts in these circumstances. This is useful guidance to the extent that directors may be concerned about being criticised for using the trading halt mechanism. That said, the regular use (or perceived over-use) of the trading halt mechanism by an entity as a means of managing its continuous disclosure obligations could lead to investors who depend on trading remaining open becoming wary of investing in the entity. It remains to be seen how this tension will be resolved but we submit that GN8 should acknowledge this tension.

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[6] [2009] WASCA 62.

[7] *Australian Securities and Investments Commission v Fortescue Metals Group Ltd (No 5)* [2009] FCA 1586

[8] *Forrest v Australian Securities and Investments Commission* [2012] HCA 39 at [76].

[9] GN8 section 3.5.

GN8 notes that the fact that an entity is in a trading halt does not 'technically' relieve it from the obligation to disclose immediately. GN8 suggests that the ASX will not take this point:[10]

> '...ASX does not apply the Listing Rules in a technical manner but rather in a manner that accords with their spirit, intention and purpose, and in a way that best promotes the principles on which they are based.'

Whilst it is acknowledged that the ASX may not be in a position to amend Listing Rule 3.1 to exempt its application during a trading halt (or suspension), we submit that GN8 should note that a trading halt signals to the market that trading should not occur either on market or off market; and any trading that does occur will be at the risk of the traders concerned. That should more clearly avoid the entity and its directors being exposed to potential liability (certainly as a practical matter).

Trading halts cannot of course address the situation where an entity is unclear whether disclosure is required and needs time to determine that. To be granted a trading halt, an entity must tell the ASX what the issue is, and it is unlikely that the ASX would allow the entity to emerge from the trading halt without saying anything to the market as to why it went into the trading halt. There is no ready solution to this issue, although we submit that GN8 should acknowledge that the ability to request a trading halt will not necessarily provide a mechanism to address delay in all cases.

The role of the board in creating information

GN8 recognises that, where it is the decision of the board itself that is the information to be disclosed under Listing Rule 3.1 (such as a decision by the board to declare a special dividend), the obligation to disclose generally will not arise until the board has made the decision.[11] It usually will not be necessary to request a trading halt ahead of that decision (unless it seems information about the impending board decision has leaked).

This is a sensible observation, although it remains unclear how far it can be taken in assisting on the question of when an entity becomes 'aware' of information which depends to a large extent on a board decision. For example, it is common under companies' continuous disclosure policies that financial forecasts must be adopted by the board, and any changes to the forecast must be approved by the board. Management may form the view that a forecast will not be met based on trading results to date and the current business plan. But the directors could take a different view, or the entity's business plan could be adjusted[12] to include initiatives which should ensure that the forecast is met – for example by deferring expenditure.

In these circumstances it should follow[13] that unless and until the board considers all the circumstances and decides on remedial action (if any), it cannot be said that the forecast will

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[10] GN8 section 3.6 page 13.

[11] GN8 section 3.8

[12] See GN8 section 6.3 page 37: 'The fact that an entity's earnings may be materially ahead of or behind market expectations part way through a reporting period does not mean that this situation will prevail at the end of the reporting period. The situation may change due to changes in the many variables that can affect an entity's earnings. It may also change because the entity adjusts its business plans in response.'

[13] Depending of course on the nature of the remedial action – for example, the deferring of expenditure which is necessary to maintain the future earning capacity of the business would likely be considered to have a negative impact on the entity's security price, even though the current forecast might still be met.

not be met. But if the board decides not to take any remedial action, claims may be made that the entity was aware (because management was aware) before the board's consideration that the forecast would not be met.

It is not clear how an issue such as this will be resolved but the difficulty it presents for entities in determining whether or not to disclose should, we submit, be recognised in GN8.

Disclosure timing, including of board generated information

GN8 in section 3.6 is ambiguous in that it states that the sensitivity of the market to information is 'at its highest' during trading hours, but then suggests that announcements of material information are required to be made during trading hours or, if the information comes to light outside trading hours, before the market next opens:

> '…if an entity becomes aware of market sensitive information that needs to be disclosed under Listing Rule 3.1:
>
> - during trading hours on licensed Australian securities markets and it is not in a position to issue an announcement straight away; or
> - outside of trading hours on licensed Australian securities markets and it anticipates that it will not be in a position to issue an announcement before trading next commences,
>
> it needs to give careful consideration to whether it is appropriate to request a trading halt.'

As a practical matter, information will not be released by the ASX to the market outside of the Company Announcement Office's business hours, which are normally 8:30am to 7:30pm (8:30pm during daylight saving) Sydney time. It would be pointless for an entity to give information to the ASX outside these times and it is very unlikely that there would be any suggestion that information coming to light after the Company Announcement Office's business hours should be sent to the ASX at that time and cannot wait until the morning.

The practical essence of the issue is therefore whether information must be released 'immediately' within either normal trading hours or (alternatively) the Company Announcement Office's business hours.

GN8 notes in section 4.4 on page 25:

> 'It is perfectly acceptable for a listed entity to arrange the signing of, and an announcement about, a market sensitive agreement at a convenient time before licensed securities markets have opened or after the licensed securities markets have closed. In fact, ASX would encourage listed entities to consider doing this to avoid disrupting the normal course of trading on licensed markets.'

Similarly, board resolutions on matters in respect of which the board's decision will generate the information, such as changes to earnings guidance or the settling of financial results, can be timed so as to avoid the requirement to release information during trading hours. This is often done when there will necessarily be a time lag after the board decision during which management prepares the appropriate presentation materials and other information for release. If the requirement as a practical matter is to give information to the ASX during the Company Announcement Office's business hours, the board decision needs to be timed to ensure it is not made until after 7.30pm (or 8.30 pm during daylight saving) Sydney time. This can be

particularly inconvenient for board members, and for analysts and the media who are expected to react promptly with commentary on significant announcements.

We submit that the ambiguity in section 3.6 of GN8 should be resolved in favour of a clear statement that the requirement to release information 'immediately' means during trading hours or, if the information comes to light outside trading hours, before the market next opens.

Leaks, speculation and rumours

Information may be withheld from disclosure if it is confidential (and the other criteria in Listing Rule 3.1A are met). However GN8 suggests that it is incumbent on the entity to ensure that there are no leaks, including by monitoring:

- the market price of its shares;
- major national and local newspapers;
- major news wire services, such as Reuters and Bloomberg;
- any investor blogs, chat-sites or other social media it is aware of that regularly include postings about the entity; and
- enquiries from analysts or journalists

for signs that the information may have leaked and to immediately contact ASX to request a trading halt if it detects any such signs.[14]

Many entities will not have the resources to undertake this degree of monitoring – particularly small cap mining and biotech companies that tend to be the subject of chat site speculation (sometimes more than large established entities). We submit that GN8 should make clear that the ASX will take a practical approach having regard to the resources available to the entity in its circumstances.

Listing Rule 3.1B will be amended to provide that that an entity must give ASX the information it 'asks for', rather than the information that is 'necessary', to correct or prevent a false market in its securities. GN8 makes clear that the ASX's discretion under the new Listing Rule 3.1B will extend to any speculation or rumour, whether correct or incorrect and wherever it appears – including comments in emails, blogs, bulletin boards, chat sites or other social media.[15]

We submit that GN8 should make clear that the ASX will be sensible in its application of the amended rule and not require companies to comment on all rumours, particularly where the publicity given to the rumour by the denial would outweigh the influence which the rumour would otherwise have.

The 'reasonable person' in Listing Rule 3.1A

The notional 'reasonable person' in the application of Listing Rule 3.1 is one who would consider information to have a material effect on the price of securities, which will be the case (under s677) if the information would influence persons who commonly invest to buy or sell.

[14] GN8 section 4.8 page 28.

[15] GN8 section 5.5, including footnote 125.

As noted above, GN8 makes clear that persons who commonly 'invest' are (in effect) value investors rather than short term traders.

The Listing Rule 3.1 test therefore reduces to whether the information would influence reasonable investors to buy or sell.

The notional 'reasonable person' in the application of Listing Rule 3.1A is one who, despite the other criteria in Listing Rule 3.1A being satisfied, would expect the information to be disclosed. GN8 in section 4.9 states that the 'reasonable person' test 'is to be judged from the perspective of an independent and judicious bystander and not from the perspective of someone whose interests are aligned with the listed entity or with the investment community'. Footnote 107 states that 'Listing Rule 3.1A.3 notably uses the term "reasonable person", rather than "reasonable investor", "reasonable security holder" or "reasonable director"'. Section 4.9 goes on to say 'It is also to be judged against the backdrop of the policy reasons underpinning Listing Rule 3.1, namely, that timely disclosure of market sensitive information is critical to the integrity and efficiency of the ASX market and other public markets on which ASX quoted securities trade'.

We submit that this broad interpretation of the 'reasonable person' test in Listing Rule 3.1A is inappropriate and not supported by the context.

It makes little sense for there to be a difference of substance between the 'reasonable person' in Listing Rule 3.1A (in effect, a reasonable investor) and the 'reasonable person' in Listing Rule 3.1A.

We submit that the natural meaning of 'reasonable person' in the context of Listing Rule 3.1A (and Listing Rule 3.1) is the intended audience of an ASX announcement, since these are rules dealing with the requirement for disclosure, or justified withholding of disclosure, to that audience.

The High Court in *Forrest v ASIC* said that the audience for an ASX announcement:[16]

> '...can be sufficiently described as investors (both present and possible future investors) and, perhaps, as some wider section of the business or commercial community. It is not necessary to define the target audience more precisely.'

This description is consistent with the 'reasonable investor' to be considered for the purposes of Listing Rule 3.1.

Whilst it is difficult to envisage circumstances where the distinction suggested by GN8 would make a difference, we submit that there should be consistency between this element of Listing Rule 3.1A and the corresponding element of Listing Rule 3.1.

The 3.1A 'reasonable person' test and disclosure of takeover approaches

GN8 expresses the view (with which we agree) in effect that the 'reasonable person' test in Listing Rule 3.1A adds little to the Listing Rule 3.1A exception where the other criteria are satisfied.[17]

GN8 does however seek to give some examples where the 'reasonable person' test might not be satisfied even where the other criteria of Listing Rule 3.1A are satisfied. One of the

[16] [2012] HCA 39 at [36] and see also [39].
[17] GN8 section 4.9.

examples given in Appendix A section H6 (**Example H6**), is where an entity is the subject of a hostile takeover bid and is approached confidentially by a potential alternative bidder who makes clear its interest will be withdrawn if the approach is disclosed. Example H6 suggests that whilst the alternative bidder's approach is confidential and concerns an incomplete proposal, a reasonable person would expect the entity to disclose it because security holders need to make a decision whether or not to accept the existing (hostile) takeover offer.

It is submitted that this guidance is inappropriate and undesirable. The rationale is not sound – if the existing bid is hostile, no doubt shareholders have been told by their board not to accept it. That is the salient information – that is, the board does not consider the bid to be acceptable – and hence shareholders are informed of what they need to know. If the entity discloses the alternative approach, it must in effect rely on the alternative bidder not withdrawing its approach as it has said it would do. If it does, then by disclosing the approach, the board has by the act of disclosing it eliminated the materiality of the information.

It is submitted that no reasonable person would expect disclosure in these circumstances.

The issue with this guidance remaining extant is that the scenario described in Example H6 will not arise, since a bidder who does not want its approach disclosed until it is ready to proceed will not approach the target entity in the first place. That could not be in the interests of security holders or the market generally.

Concluding comments

Our submissions above focus on some discrete issues which we consider should be addressed to further enhance GN8. The small number of matters raised underscores our commendation of GN8 as sound and comprehensive guidance for listed companies and their advisers, and the market generally.

We would be pleased to expand on the points made in this submission if that would be helpful.

Yours faithfully