Report on Session 5 - Continuous Disclosure and Related Party Transactions

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SUMMARY

Both the related party transaction provisions and the continuous disclosure rules which are contained in the Corporations Law present particular issues for the mining and petroleum industries. This paper reports on the discussion generated by these two topics at the 20th Annual AMPLA Conference.

INTRODUCTION

This fifth session of the 20th Annual AMPLA Conference was designed to deal in depth with corporate issues of vital concern to all lawyers working in the mining and petroleum industries. The particular topics for consideration were the related party transaction provisions contained in Pt 3.2A of the Corporations Law, and the more recent continuous disclosure regime. Although each of these topics is a distinct area of the law in itself, a common theme which emerged from the session was the extent to which the law was responsible for setting appropriate standards of corporate behaviour.

The Convenor of the session was Norman O'Bryan, a member of the

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Victorian Bar. The papers were delivered by Jon Webster of Melbourne law firm Arthur Robinson & Hedderwicks, and Charles Bagot of Adelaide law firm Piper Alderman. The discussion of the issues raised by these speakers was led by a well-balanced panel, composed of both regulators and industry representatives. Representing the regulators were Alan Cameron, chairman of the Australian Securities Commission (ASC) and Ray Schoer of the Australian Stock Exchange Ltd (ASX). The industry representatives were John Quinn from Newcrest Mining Ltd and Peter Woodford from J B Were & Sons.

Contrary to expectations, the discussion did not simply result in a two-sided affair, pitting the regulators against the regulated. As the following account of the proceedings demonstrates, even the regulators do not always share the same view as to the best way to regulate corporate behaviour.

THE PAPERS

Both speakers approached their respective topics from a very legal interpretive perspective. This legalistic approach allowed the key issues to be defined, before the panel members and conference delegates discussed the practical applications of the provisions to the mining and petroleum industries and raised their individual concerns.

Jon Webster commenced his discussion of the related party transaction provisions, which are contained in Pt 3.2A of the Corporations Law, by making the point that these provisions were merely one aspect of the law which regulated the behaviour of corporate decision-makers. Also relevant to many of the transactions under consideration, he said, were the provisions relating to directors' duties, which in many circumstances were more onerous, and also the ASX Listing Rules. Jon then presented a concise overview of the main provisions of Pt 3.2A. One of his main tasks was to give meaning to the many terms that are employed in the Part, as an understanding of terms such as "financial benefit", "related party", "child entity" and "control" was clearly essential to a proper understanding of the operation and scope of the provisions.

Jon provided examples of typical transactions between related companies to illustrate the scope of the provisions. He then briefly considered the various exemptions that were available to a public company that wished to give a financial benefit within the meaning of Pt 3.2A. In particular, he considered the arm's length transaction exemption which, of all the exceptions, was the one most often relied upon in practice. Finally, Jon noted the severity of the penalties that a company breaching the related party transaction provisions faced and, therefore, emphasised the need for all public companies to keep the provisions in mind whenever they proposed to deal with a related party.

Charles Bagot introduced the main provisions of the continuous disclosure regime, which was introduced into the Corporations Law by the

Corporate Law Reform Act 1994 (Cth). Charles discussed the impact of the introduction of s 1001A into the Law, pointing to how this section had enhanced the disclosure requirements contained within the ASX Listing Rules. This discussion necessarily involved consideration of Listing Rule 3.1 (formerly Listing Rule 3A(1)), in which the fundamental disclosure obligations are to be found. Importantly for practitioners in the field, Charles then discussed some of the exceptions to the Listing Rule and provided examples of the types of information that he considered would be protected from disclosure by these exceptions. Charles completed his discussion by considering the relationship between the continuous disclosure regime and s 1022AA of the Corporations Law, which provides for the use of transaction-specific prospectuses in certain circumstances.

THE DISCUSSION

Much of the discussion of the issues raised by the speakers occurred in the context of a hypothetical that was distributed to delegates. This hypothetical, a copy of which is contained in Appendix A to this paper, raised a number of issues relating to both related party transactions and continuous disclosure.

Related party transactions

Who should regulate?

One of the main issues discussed by the panel members in relation to the related party transaction provisions was the question of which regulator should have the responsibility for regulating this area of the law. It was on this point that Alan Cameron and Ray Schoer demonstrated that the regulators do not always agree. In what was clearly an ongoing debate, Alan and Ray presented opposing views of the current system of regulation.

Ray was critical of the overlap between Pt 3.2A and the ASX Listing Rules.[1] The ASX, he said, believed that there should be only one regulator in this area and was, therefore, opposed to the introduction of Pt 3.2A into the Corporations Law. Ray argued that the dual regulation that resulted from the introduction of Pt 3.2A, in turn resulted in duplication, inconsistencies and overlaps. Such dual regulation, he argued, should therefore be avoided.

Although the ASX preferred that there be only one regulator, it did not

1. Chapter 10 of the ASX Listing Rules (formerly Listing Rule 3J(3)) deals with transactions between an entity and persons in a position of influence to the entity. Transactions covered by Chapter 10 include acquiring and disposing of substantial assets by the entity, and acquiring securities in the entity. The Chapter also deals with participation by directors (and persons associated with directors) in employee incentive schemes and in underwriting dividend or distribution plans, payments to directors and termination benefits.

automatically assume this role for itself. Ray indicated that the ASX was currently reviewing Ch 10 of the Listing Rules and was considering whether the rules contained in this Chapter ought to be retained. An underlying philosophy of the ASX, he said, was that it was willing to vacate a field in favour of the ASC if it could be shown that the Corporations Law adequately regulated the field. Ray suggested, however, that even if the ASC was to assume the primary regulatory function in relation to related party transactions, the ASX would perhaps be prepared to retain a safety net role by regulating "significant transactions" of listed public companies.

In contrast, Alan Cameron argued that there was not only room for, but in fact a need for both regulatory regimes. He pointed out, however, that this did not mean that he was suggesting that there should be inconsistent rules. It would be absurd, he said, if it was impossible for companies to comply with both regimes.

Alan argued that the Corporations Law and the ASX Listing Rules performed different, although complimentary, functions. Part 3.2A of the Corporations Law, he said, should be viewed as a summary of the minimum requirements expected of all public companies, whereas the Listing Rules were aimed much higher and were concerned with achieving best practice.

Alan claimed the very nature of the two regimes also determined that they perform different functions. The Listing Rules, he said, provided the ASX with a degree of flexibility and discretion that was "highly desirable". If the Corporations Law was to become the sole regulator, the ASC would need to be able to exercise this degree of flexibility. However, Alan considered that such an exercise of discretion was inappropriate for the statutory regulator. This was because decisions of the ASC were subject to full administrative review and, even if they were not, as a statutory regulator the ASC was not as in tune with market realities as was the ASX as the frontline regulator.

The existence of dual regulation was not a major concern of the other members of the panel or the conference delegates. Instead, their primary concerns related to the scope of the provisions and the types of transactions that fell within their ambit.

What should be regulated?

The main criticism levelled at Pt 3.2A by the industry representatives was the lack of any concept of "significance" or "materiality" in relation to the types of transactions that were regulated by the Part. The absence of such concepts, it was argued, meant that certain transactions that did not in any way deplete the resources of the company technically fell within the related party transaction provisions. The application of these provisions to such transactions, it was argued, resulted in an unnecessary burden to shareholders.

It was suggested, however, that this approach misconceived the purpose of the provisions. It was argued that a wider perspective needed to be

adopted in relation to the function of Pt 3.2A. This Part, it was suggested, was not so concerned with diminution of company resources, as with the enrichment of insiders or other privileged persons at the expense of others who might be dealing with the company.

Alan Cameron responded to the call for the introduction of a materiality concept by arguing that, although he could understand the desire among the business community to have a materiality test introduced into the related party transaction provisions, the law was unwilling to adopt this concept. This, he argued, was because of the difficulties in defining what was material. These difficulties primarily arose out of the fact that the concept of materiality varied according to the circumstances and size of the particular company under consideration.

Jon Webster also commented that the lack of any such concept in Pt 3.2A of the Law was inconsistent with the approach currently being considered in relation to the financial assistance provisions contained in s 205. He agreed, however, that it was impossible to provide a definition of materiality that would be generally applicable. In light of this difficulty, he questioned whether the prohibition in Pt 3.2A was needed at all. Instead, he suggested that the types of transactions that were intended to be regulated by Pt 3.2A could be better regulated through the application of general directors' duties to act in the best interests of the company, an approach that would address industry concerns about the unnecessary impact of the regulations in certain circumstances. Alternatively, John suggested that it could be argued that such transactions were inherently wrong and therefore should be prohibited per se. If such an approach was adopted, calls for the introduction of a concept of materiality would clearly be misconceived.

Continuous disclosure

Of most interest to the delegates in relation to the continuous disclosure regime was the type of information that was required to be disclosed and the timing of such disclosure. One of the main themes arising out of the discussion was whether the law should provide greater guidance in relation to the types of information that should be disclosed or whether an onus rested on companies themselves to exercise their own judgment.

What should be disclosed?

A major criticism levelled at the continuous disclosure regime was that it could be used by smaller mining companies to manipulate the market. This appeared to be a particular problem in the mining industry, where the information available was often highly speculative, and any premature announcement based upon this speculative information could have dramatic effects on the share price of the disclosing company. Such premature disclosure was seen to be a particular problem in relation to joint venture agreements between smaller and larger companies. Although there was a general feeling that, in such circumstances, smaller joint venturers

were much more willing to release information earlier, there was some disagreement about the impact of the release of this information on the market.

John Quinn noted that what was often being released by these companies was data and not information. The problem, he argued, was the release of this data without any interpretation. He suggested that the continuous disclosure rules did not adequately distinguish between data and information and believed that this led to situations where the market could be actively manipulated. This manipulation, he suggested, was aided and abetted by the continuous disclosure rules in absolute contravention of their intentions.

In contrast, Peter Woodford claimed that such releases had very little effect on the market price of securities, and he indicated that, as a practitioner in the field, he took little notice of such disclosures.

The content of a disclosure would also be dictated by what information had already been disclosed to the market, whether through stock exchange announcement or other means. Discussion on this point necessarily turned to s 1001C, which provides guidance as to when information will be generally available for the purposes of ss 1001A and 1001B. Section 1001C states that information will be generally available if it has been made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in securities of a kind whose price or value might be affected by the information. The discussion, therefore, centred on to whose attention the information must have been brought and, more particularly, whether s 1001C required that the information be made known to all persons who commonly invest in such securities, or only a group of them and, if a group was sufficient, how large that group must be.

It was suggested that the requirement that the information be disclosed to persons who commonly invest in a class of securities would be satisfied where a stockbroker's dissemination of the market information to major institutional investors had occurred. Alan Cameron was, however, highly critical of this interpretation. He regarded it as anomalous and highly unsatisfactory that the requirement that the market be informed might be satisfied when particular information had been provided to institutional investors, but other investors who seek to keep themselves well informed had no opportunity of knowing it. He admitted, however, that the fact that an individual investor is required to act through a broker, meant that in practical terms he or she would most likely be informed of the information before making any investment decisions.

When to disclose?

A further issue raised by the continuous disclosure regime, was the point at which information must be disclosed. This was seen as a particular problem in relation to mining companies, which were constantly being supplied with preliminary data, much of which would ultimately prove to be of little value. Despite a claim by Peter Woodford that he had yet to find a

listed company that did not want to announce what it had discovered as quickly as possible to assist their fund raising, this was obviously a very real and difficult question for the industry.

It was agreed that there was no definitive answer to this question. The general feeling, although it was expressed in different ways, was that a materiality test needed to be applied. Peter Woodford expressed this test by suggesting that a company should decide when to disclose a discovery by asking itself "at what point would its shareholders be dealing in their shares in ignorance of the discovery or near discovery that the company had made?"

On a practical note, it was noted that mining companies were constantly exploring and receiving data from their activities, and their shareholders understood that. Therefore, it was unrealistic to expect a company to make a disclosure each time it commenced work at a new site. Any disclosure would need to turn on the significance of any find. Ray Schoer suggested that, in some circumstances, it would be necessary to disclose that nothing had been found; for example, where the company had built up expectations of an imminent discovery. There had to be a purpose for making the announcement, however, and that purpose was ultimately related to whether the discovery, or lack of one as the case may be, would be expected to affect the price of the company's securities and the decisions of the people who trade in those securities.

The point was also made that the concept of materiality necessarily varied according to the size of the company making the disclosure. Again, this point was raised in the context of joint ventures involving both larger participants and smaller partners. In such cases, information that would not be considered material in relation to the larger company could be expected to have a material influence on the market price of the securities of the smaller company and, therefore, should be disclosed by that company. A number of the delegates provided examples of exactly this situation occurring and indicated that this differing standard of materiality was at the heart of many of the tensions that commonly existed among joint venture participants in relation to compliance with the compulsory disclosure requirements.

CONCLUSION

The discussion generated by the related party transaction provisions and the continuous disclosure rules demonstrated that both of these legislative regimes pose very real issues for the mining and petroleum industries. This discussion also demonstrated that the road to compliance was far from trouble free and that no simple answers were available. Additionally, although the law provided some guidance as to the appropriate standards of corporate behaviour, the overriding consideration must be the company's duty to its shareholders and to the investing public.