

Article Information

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Cleansing notices - the costs of the failure to lodge

Re Superior Resources Ltd (ACN 122 844 407) [2020] FCA 635 is a timely reminder of the significant consequences for listed entities undertaking placements who fail to comply with their disclosure obligations.

What happened?

In *Re Superior Resources Ltd (ACN 122 844 407) [2020] FCA 635*, the company announced a placement and then proceeded to lodge a cleansing notice on the same day. The shares were placed sometime after the announcement but without a further cleansing notice being lodged. The result was that the subsequent offer and sale of those shares by a placee was a breach of the *Corporations Act 2001* (Cth).

As soon as it became aware of the issue, Superior Resources Ltd sought suspension of its shares on the ASX. It then sought declarations from the Court to validate any trading of those shares that had occurred, and to further relieve the placee shareholders of any civil liability in trading those shares in the absence of a cleansing notice.

The Law

Sections 707, 708A and 727 of the Corporations Act contain the 'on-sale provisions' which establish a framework to ensure that retail investors receive adequate disclosure where shares are first issued without disclosure (for example, to sophisticated investors) and then sold on market. The effect is that recipients of securities without disclosure are prohibited from selling those securities within 12 months of their issue until there has first been disclosure to the market. That disclosure usually takes the form of a cleansing notice from the company (if the company can satisfy s 708A(5) of the Corporations Act), or otherwise a cleansing prospectus under s 708A(11) of the Corporations Act.

A sale of securities issued without disclosure within 12 months of issue, in the absence of a cleansing notice or cleansing prospectus, is a breach by the seller of s 727(1) of the Corporations Act. It carries potential civil and criminal liability for the seller, including up to 15 years imprisonment. Further, such a breach may result in the company incurring liability to the ASX, having its securities suspended from trading by the ASX, or being the subject of civil claims brought against it by any current or former aggrieved shareholders.

What to do about it?

Where a company discovers that it has breached the on-sale provisions, it should take immediate action. The action to be taken will depend on the circumstances of the company, but may include one or more of the following:

- contacting the ASX to suspend trading;
- contacting the relevant shareholders in receipt of those placement securities to notify them of the issue, and potentially to place those securities into escrow; and
- lodging a cleansing prospectus (if one has not already been lodged).

It is also common to apply to the Court to seek declarations under s 1322(4) of the Corporations Act to remedy the breaches. Such declarations can be to the effect that:

- any offer for sale, or sale, of the relevant securities during the period in which there was no disclosure for those

securities, is not invalid by reason of the sellers' failure to comply with ss 707(3) and 727(1) of the Corporations Act;

- any seller of the relevant securities be relieved from any civil liability arising out of a contravention of ss 707(3) and 727(1) of the Corporations Act; or
- the period in which the cleansing notice can be given is extended (such that the company is able to issue a cleansing notice after the order is made), and that the effective date of such cleansing notice is the day after the day on which the subject securities were issued.

Depending on the declaration(s) sought, the Court must satisfy itself of one or more of the following:

- that the act done is essentially of a procedural nature (noting that there have been instances of the Court finding that a failure to lodge a cleansing notice was not an act procedural in nature);
- the person concerned in the contravention acted honestly;
- that it is just and equitable that the orders be made;
- that the sellers acted honestly; and
- that no substantial injustice has been or is likely to be caused to any person.

The Court may also look to surrounding circumstances, including the compliance culture of the company and how its officers acted after becoming aware of the breach. This further highlights the importance for listed companies to have a robust continuous disclosure policy in place that is faithfully implemented, and regularly reviewed.

Once the sought Court declarations are made (and where applicable, cleansing notices are lodged with the ASX) ordinary trading in the company's securities may resume.

For more information, please contact [Sina Kassra](#).