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The Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam,

We welcome the opportunity to provide feedback in relation to the Committee's inquiry into the *Treasury Laws Amendment (2021 Measures No.1) Bill 2021* (**the Bill**).

Let me offer some commentary on the general themes within the Bill, before providing a Briefing Note which outlines legal opinion on specific clauses contained in Schedule 2.

A significant new winding back of investor protections …

We note the purpose of the changes set out in Schedule 2, as detailed in the Minister's second reading speech[1]:

> *Schedule 2 to the bill will amend our continuous disclosure laws so that companies and their officers will only be liable for civil penalty proceedings where they have acted with knowledge, recklessness or negligence with respect to updates on price-sensitive information to the market. Schedule 2 makes permanent the temporary relief introduced by the government in response to the coronavirus crisis on 25 May 2020 and extended until 22 March 2021.*

In fact however, the Bill goes further than merely making permanent the temporary measures put in place to assist with COVID recovery.

The Minister goes on to say:

> *Schedule 2 also introduces the same standard of liability for misleading and deceptive conduct where an entity or officer has allegedly failed to provide an*

[1]https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansardr%2F14059f01-aa4f-4143-a7dc-fa5f407d6e45%2F0017%22

> *update with price-sensitive information to the market. This ensures that those who bring class actions for an alleged failure to update the market must prove the company or officer has acted with knowledge, recklessness or negligence, whether they bring the action under continuous disclosure or misleading and deceptive conduct.*

Maurice Blackburn believes that the Bill will seriously limit Australia's continuous disclosure regime, potentially leaving shareholders without a remedy in cases where companies seriously misinform the market.

… including untested proposals.

Extending the Bill to also weaken the capacity to protect against misleading and deceptive conduct is, we believe, a risky untested proposal. This was not included in the temporary measures introduced in March.

Nor was there a recommendation related to misleading and deceptive conduct made by the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into litigation funding and the regulation of the class action industry – despite the very wide-ranging scope of that Committee's considerations.

… and allowing directors and advisors to blame shift and avoid responsibility

The Bill also brings into sharp focus the relationship between company directors and their auditors.

Maurice Blackburn is concerned that the changes proposed in the Bill will merely create an environment where directors are able to hide behind their auditors (and vice versa) when published financial statements are seriously misleading. This is discussed in more detail in the attached briefing note.

The problem extends beyond financial statements. Maurice Blackburn has for some time been aware of the widespread practice by corporate entities of commissioning investigations or reviews by third parties such as large accounting and auditing firms and then submitting those reports to regulators or to the public as 'independent'.

This practice came explicitly to public attention during the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry[2], where it became known that reports characterised as 'independent' had been submitted to ASIC after a number of drafts passed between the directors and the auditors, and significant changes were made at the directors' request.

Companies will say they weren't negligent because they relied on an adviser, the adviser won't be liable because the company isn't and shareholders will be left damaged by serious misconduct.

… and giving free reign to the corporate cover up.

Everyday investors who have been victims of misleading information often start their case for damages knowing there has been a serious failure in the information provided to the market but with no evidence as to the 'state of mind' of the company. It is often not until the commencement of the discovery phase of proceedings that we find that directors have been deliberately, recklessly or negligently misleading.

[2] https://financialservices.royalcommission.gov.au/Documents/interim-report/interim-report-volume-2.pdf; s.1.10.2,

The critical point here is that many cases of purposeful, wilful misconduct (let alone negligence) would never be uncovered if proceedings never make it to the discovery phase. This Bill rewards corporate cover-ups by making that significantly harder.

Who benefits?

It is difficult not to see this Bill as part of a broader policy agenda for which the recovery from the coronavirus recession is not a reason but is rather an excuse. These now include:

- Removing safeguards that protect consumers from predatory lenders;
- Taking power away from employees who want a pay rise;
- Leaving working age people no choice but to run down their retirement savings; and
- Making it harder for everyday shareholders to get justice.

Who benefits?

Below, we provide for the benefit of the Committee a Briefing Note containing legal opinion on the two elements of the Bill which relate to the potential impacts of specific clauses within the Bill.

Maurice Blackburn reiterates our belief that the Bill will seriously wind back Australia's continuous disclosure regime potentially leaving shareholders without a remedy in cases where companies seriously misinform the market.

We would be pleased to discuss the Bill directly with the Committee.

Yours faithfully,

Andrew Watson
Principal Lawyer
MAURICE BLACKBURN

BRIEFING NOTE RE TREASURY LAWS AMENDMENT (2021 MEASURES NO. 1) BILL 2021 – CONTINUOUS DISCLOSURE/MISLEADING AND DECEPTIVE CONDUCT AMENDMENTS

Introduction

1. The purpose of this note is to consider the implications of the *Treasury Laws Amendment (2021 Measures No. 1) Bill 2021* (**the Bill**) in relation to the continuous disclosure regime and the prohibitions on misleading and deceptive conduct in the *Corporations Act 2001* (**CA**) and the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**).

2. Last year the Treasurer temporarily modified the continuous disclosure provisions of the CA pursuant to COVID directions. In essence the Bill seeks to make those temporary changes permanent and extend the reach of those changes to misleading and deceptive conduct provisions in the CA and ASIC Act.

3. The Bill will significantly wind back Australia's continuous disclosure regime potentially leaving shareholders without a remedy in cases where companies seriously misinform the market.

The proposed change to continuous disclosure laws

4. The Bill takes the existing s.674 which imposes criminal and civil liability for breaches of continuous disclosure by listed entities and civil liability for breaches by persons involved in a listed entity's contravention and leaves s.674 substantially unchanged for criminal liability (ie ASIC criminal prosecutions which almost never happen) and then introduces a new s.674A dealing with civil liability. Attached is a comparison of s.674 as it is now, as it will be after the amendments and the new s.674A.

5. Consequential changes are then made to s.675, 676 and 677 with the introduction of a new s.675A (not reproduced).

6. The critical change effected by the Bill is a change from a requirement:

    a. that the information not disclosed *is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities of the entity*: current s.674(2)(c)(ii);

    to a requirement that

    b. *the entity knows, or is reckless or negligent with respect to whether, the information would, if it were generally available, have a material effect on the price or value of ED securities of the entity*: proposed s.674A(2)(d)

7. If a contravention of the proposed section 674A could only be satisfied by the establishment of knowledge or recklessness the impact of the amendment would be far reaching and dramatic in effect completely substituting an objective test (what is reasonable) for a subjective test. However, the inclusion of the words "*or negligent*" embody an objective standard – a person may act honestly (that is without intention or recklessness) but negligently because they fail to exercise *reasonable* care.

8. What if any conduct is covered by the old s.674 that is not covered by the new s.674A? Having considered the question extensively the following possibilities arise:

a. The term *negligence* embodies not just a failure to exercise reasonable care but requires the establishment of a duty of care;

b. The new subsection effectively renders impossible cases where a company's reliance on advisors such as auditors leads to the market being misinformed;

c. the proposed new section will allow companies to play attribution games, for example say that even though someone in the company had the information because the Board or senior executives didn't know they were not negligent and therefore the entity was not negligent.

A duty of care?

9. If the term negligence required a duty of care to be established the scope of the section might be significantly narrowed from the existing provision. The common law has not traditionally recognised a tortious duty of care owed by a company to its shareholders, nor at common law or under statute do directors owe duties to shareholders; rather, their duties (eg s180 of the CA) are to the company itself and not its shareholders. Additionally, establishing a duty of care in cases of pure economic loss (which may be how shareholder losses are characterised) is hard and this would be particularly so in relation to people who aren't currently shareholders but who acquire their shares on the basis of the company's misinformation and who from any policy perspective ought to be protected by the regime.

10. There are significant contraindicators to this interpretation:

a. the fact that the negligence is "*with respect to whether the information etc*" suggests that what is intended is a failure to exercise reasonable care and not the additional requirement of a duty owed to particular persons;

b. the Explanatory Memorandum accompanying the Bill describes the change as introducing "*a mental element*" into the civil continuous disclosure regime: see for example clause 2.5 and 2.11 of the EM; and

c. *negligence* and *negligent* are used elsewhere in the CA in contexts which suggest that all that is meant is a failure to exercise reasonable care without the superadded requirement of establishing a duty of care in the first place.

11. The strongest argument which might be made for the imposition of the requirement to establish a duty of care is that if the Bill becomes law parliament must have intended that there be some change to the civil continuous disclosure provisions and that if negligence simply means a failure to take reasonable care then arguably there has been none (though this will not be so if the propositions in 8.b and 8.c are correct).

12. On balance the possibility that the new s.674A requires establishing a duty of care seems unlikely and the better view is that it does not but it cannot be said there is no risk a court would reach this view.

Accounting misstatements get a free pass?

13. Potentially the most concerning consequence of the change might be in relation to misstatements in published accounts (eg: false profit numbers, misstated debt figures, revenue wrongly recognised).

14. Suppose a company publishes accounts which wrongly recognise revenue and therefore overstate profit by tens of millions of dollars. Under the current s.674 the true

level of the revenue and the profit is a matter which a reasonable person would expect to have a material effect on the price or value of the shares. Shareholders who had bought shares in the misinformed market would be able to recover losses from the company, its auditors or more likely both (because in practice the company and it auditors will blame each other for the mistake).

15. However, under the proposed s.674A the company will be able to say that it relied on its auditors and was not therefore negligent. No action will then lie against the company. Further no action will lie against the auditors under s.674A because they cannot be *involved* in a contravention by the entity and because of the proposed changes to the misleading and deceptive conduct legislation (discussed below) the auditors' conduct may not contravene those provisions meaning that, in effect, shareholders will go without compensation for something as fundamental as a misstatement of profit.

16. There is simply no good policy basis on which shareholders should be denied a remedy to recover their losses in circumstances of serious misstatement in financial accounts yet that is the almost inevitable consequence of the proposed changes.

17. Where the company has not actively misled the auditors for the reasons discussed above there will likely be no contravention of s.674A by either the company or its auditors.

18. Even in those cases where the company has actively misled the auditors shareholders will still often be denied a recovery. First because the misleading of the auditor may not be knowledge, recklessness or negligence *with respect to whether, the information would, if it were generally available, have a material effect on the price or value of ED securities of the entity.* Secondly, in many instances, as a practical matter, shareholders may never be in a position to commence an action because they won't be able to allege the requisite knowledge, intention or recklessness without discovery of documents and they won't be able to obtain discovery because they won't be able to allege the requisite mental element.

19. This situation will apply to almost any material misstatement in financial accounts. Examples of cases which might not have commenced under the proposed s.674A are:

    a. *Aristocrat* misstatement of profit because of wrongful recognition of sales revenue from suspect South American transactions – settled for $144.5m;

    b. *Centro* incorrect classification of billions of dollars of debt as non-current during the global financial crisis – settled for $200m

    c. *Allco* incorrect classification billions of dollars of debt as non-current during the global financial crisis – settled for $40m

    d. *NAB* alleged failure to write down the value of toxic CDOs in the global financial crisis – settled for $115m.

20. A company's reliance on its auditors is the most obvious example of a situation which may give rise to a problem under the proposed section but the issue will arise in any circumstance where a company relies on advisors (lawyers, industry specialists, investment bankers). Indeed one likely outcome if the Bill becomes law is a cottage industry for defendant lawyers signing off on proposed non-disclosure or incomplete disclosure with both the company and its lawyers safe in the knowledge that the combination of legal professional privilege and the new provisions will ensure an

effective free pass from any scrutiny whether or not the advice is based on misinformation or incomplete information provided by the company and/or whether the advice itself is negligent or wrong.

Attribution games

21. The proposed new s.674A requires the *entity* to be negligent. As noted above this is described as introducing a mental element to the continuous disclosure regime. A company will be vicariously liable for the negligent *acts* of its employees or agents but the attribution of a *state of mind* to a corporation is sometimes limited to its Board and senior executives. If negligence in the new s.674A is to be treated as a state of mind boards and senior executives will be able to say they were not negligent *with respect to* whether information should have been disclosed if they did not have it, whether or not they ought to have had it.

22. In short, the proposed legislation encourages the "I know nothing" defence. This will potentially impact in cases of serious misconduct at lower levels of the company which for whatever reasons have not come to the attention of the board. Situations like the recent events at Crown or the AMP Fee for No Service debacle show the serious danger of a disclosure regime which relies on boards actually having the information they should.

23. The ASX Listing rule requires disclosure of information which officers of the company knew or ought to have known and so recognises the problem of the company whose systems or culture in relation to reporting of bad news are deficient or which honestly but unreasonably makes forecasts but the proposed s.674A will potentially exacerbate a problem which already exists as a result of decisions like *Babcock and Brown* and *Myer.*

24. Section 674(2)(b) should be amended to ensure that a company is liable for the negligent acts of its employees by introducing the words in italics "the entity has *or ought to have* information …" and s.674(2)(c) should stay in its existing form so that companies with deficient systems of information flow or who make forecasts which are based on unreasonable grounds do not avoid liability for misstatements to the market.

Misleading and deceptive conduct

25. The Bill excludes certain conduct from the misleading and deceptive conduct provisions in s.1041H of the CA and s.12DA. Conduct which does not contravene s.674A(2) but would contravene that subsection if s.674A(2)(d) contained the same text as the proposed s.674(2)(d) is defined not to constitute a contravention of those provisions.

26. If the analysis in paragraphs 13 to 20 is correct this is a real and very significant problem. Material misstatements in financial statements will in effect be impossible to pursue unless it can be shown the company actively misled its auditors.

27. The changes to the misleading and deceptive conduct provisions may not be as great a problem in relation to situations where board and officers ought to have had information but did not (discussed in 21 to 24 above) because on the current state of the authorities that would probably not constitute a contravention of s.674A(2) even if it had the same text as 674(2)(d) because the company would be held not to *have* the information. Ironically though if this approach to the interpretation of s.674(2)(b) is overturned in the forthcoming *Worley Parsons* appeal then the proposed amendment will have the effect

of providing a complete excuse to the company which ought to have information but does not.

Andrew Watson
Principal Lawyer, Maurice Blackburn

Current s.674	New s.674A	New 674
674 Continuous disclosure—listed disclosing entity bound by a disclosure requirement in market listing rules *Obligation to disclose in accordance with listing rules* (1) Subsection (2) applies to a listed disclosing entity if provisions of the listing rules of a listing market in relation to that entity require the entity to notify the market operator of information about specified events or matters as they arise for the purpose of the operator making that information available to participants in the market. (2) If: (a) this subsection applies to a listed disclosing entity; and (b) the entity has information that those provisions require the entity to notify to the market operator; and (c) that information: (i) is not generally available; and (ii) is information that a	**674A Continuous disclosure—listed disclosing entity bound by a disclosure requirement in market listing rules—knowledge, recklessness or negligence** (1) Subsection (2) applies to a listed disclosing entity if provisions of the listing rules of a listing market in relation to that entity require the entity to notify the market operator of information about specified events or matters as they arise for the purpose of the operator making that information available to participants in the market. (2) If: (a) this subsection applies to a listed disclosing entity; and (b) the entity has information that those provisions require the entity to notify to the market operator; and (c) the information is not generally available; and (d) the entity knows, or is reckless or negligent with respect to whether, the information	**674 Continuous disclosure—listed disclosing entity bound by a disclosure requirement in market listing rules – reasonable person's expectations** *Obligation to disclose in accordance with listing rules* (1) Subsection (2) applies to a listed disclosing entity if provisions of the listing rules of a listing market in relation to that entity require the entity to notify the market operator of information about specified events or matters as they arise for the purpose of the operator making that information available to participants in the market. (2) If: (a) this subsection applies to a listed disclosing entity; and (b) the entity has information that those provisions require the entity to notify to the market operator; and (c) the information is not generally available; and

reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities of the entity; the entity must notify the market operator of that information in accordance with those provisions. Note 1: Failure to comply with this subsection is an offence (see subsection 1311(1)). Note 2: This subsection is also a civil penalty provision (see section 1317E). For relief from liability to a civil penalty relating to this subsection, see section 1317S. Note 3: An infringement notice may be issued for an alleged contravention of this subsection, see section 1317DAC. (2A) A person who is involved in a listed disclosing entity's contravention of subsection (2) contravenes this subsection. Note 1: This subsection is a civil penalty provision (see section 1317E). For relief from liability to a civil penalty relating to this subsection, see section 1317S. Note 2: Section 79 defines ***involved***. (2B) A person does not contravene	would, if it were generally available, have a material effect on the price or value of ED securities of the entity; the entity must notify the market operator of that information in accordance with those provisions. Note 1: Except for paragraph (d), this subsection is identical to subsection 674(2). Note 2: This subsection is a financial services civil penalty provision (see section 1317E). As a result, compensation orders are available for contraventions of this subsection (see section 1317HA). For relief from liability relating to this subsection, see section 1317S. Note 3: This subsection does not create an offence (see subsection 1311(1A)). (3) A person who is involved in a listed disclosing entity's contravention of subsection (2) contravenes this subsection. Note 1: This subsection is a financial services civil penalty provision (see section 1317E). As a result, compensation orders are available for contraventions of this subsection (see section 1317HA). For relief from liability relating to this subsection, see section 1317S. Note 2: Section 79 defines ***involved***.	(d) a reasonable person would expect the information, if it were generally available, to have a material effect on the price or value of ED securities of the entity; the entity must notify the market operator of that information in accordance with those provisions. Note 1: Failure to comply with this subsection is an offence (see subsection 1311(1)). Note 3: An infringement notice may be issued for an alleged contravention of this subsection, see section 1317DAC. (3) For the purposes of the application of subsection (2) to a listed disclosing entity that is an undertaking to which interests in a registered scheme relate, the obligation of the entity to notify the market operator of information is an obligation of the responsible entity. (3A) For the purposes of the application of subsection (2) to a listed disclosing entity that is an undertaking to which interests in a notified foreign passport fund relate, the obligation of the entity to notify the market operator of information is an obligation of the operator of the fund.

subsection (2A) if the person proves that they: (a) took all steps (if any) that were reasonable in the circumstances to ensure that the listed disclosing entity complied with its obligations under subsection (2); and (b) after doing so, believed on reasonable grounds that the listed disclosing entity was complying with its obligations under that subsection. (3) For the purposes of the application of subsection (2) to a listed disclosing entity that is an undertaking to which interests in a registered scheme relate, the obligation of the entity to notify the market operator of information is an obligation of the responsible entity. (3A) For the purposes of the application of subsection (2) to a listed disclosing entity that is an undertaking to which interests in a notified foreign passport fund relate, the obligation of the entity to notify the market operator of information is an obligation of the operator of the fund. (4) Nothing in subsection (2) is	(4) A person does not contravene subsection (3) if the person proves that the person: (a) took all steps (if any) that were reasonable in the circumstances to ensure that the listed disclosing entity complied with its obligations under subsection (2); and (b) after doing so, believed on reasonable grounds that the listed disclosing entity was complying with its obligations under that subsection. (5) For the purposes of this section, subsections 674(3) and (3A) apply as if each reference in those subsections to subsection 674(2) were replaced by a reference to subsection (2) of this section. (6) Nothing in subsection (2) is intended to affect or limit the situations in which action can be taken in respect of a failure to comply with provisions referred to in subsection (1). (7) Subsection 1317QB(1) (state of mind) does not apply in relation to subsections (2) and (3) of this section. Note: In relation to subsection (3) of this section, see also	(4) Nothing in subsection (2) is intended to affect or limit the situations in which action can be taken (otherwise than by way of a prosecution for an offence based on subsection (2)) in respect of a failure to comply with provisions referred to in subsection (1). *Obligation to make provisions of listing rules available* (5) If the listing rules of a listing market in relation to a listed disclosing entity contain provisions of a kind referred to in subsection (1), the market operator must ensure that those provisions are available, on reasonable terms, to: (a) the entity; or (b) if the entity is an undertaking to which interests in a registered scheme relate—the undertaking's responsible entity; or (c) if the entity is an undertaking to which interests in a notified foreign passport fund relate—the operator of the fund. Note 1: Failure to comply with this subsection is an offence (see subsection 1311(1)). Note 2: This subsection is not a civil penalty provision, as it is not listed in the table in

intended to affect or limit the situations in which action can be taken (otherwise than by way of a prosecution for an offence based on subsection (2)) in respect of a failure to comply with provisions referred to in subsection (1). *Obligation to make provisions of listing rules available* (5) If the listing rules of a listing market in relation to a listed disclosing entity contain provisions of a kind referred to in subsection (1), the market operator must ensure that those provisions are available, on reasonable terms, to: (a) the entity; or (b) if the entity is an undertaking to which interests in a registered scheme relate—the undertaking's responsible entity; or (c) if the entity is an undertaking to which interests in a notified foreign passport fund relate—the operator of the fund. Note: Failure to comply with this subsection is an offence (see subsection 1311(1)).	subsection 1317QB(2).	subsection 1317E(3).