

**SUBMISSION TO SENATE OF AUSTRALIA ECONOMICS REFERENCES
COMMITTEE INQUIRY INTO THE TREASURY LAWS AMENDMENT (2021
MEASURES NO.1) BILL 2021 [PROVISIONS]**

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I thank Honourable Senators for the invitation and opportunity to submit to the Senate Committee.

This submission focuses on the continuous disclosure and misleading and deceptive conduct changes in *Treasury Laws Amendment (2021 measures no.1) Bill 2021*(Cth) ('the changes').

This submission focuses heavily on the position of corporations (rather than officers) as defendants to shareholder class actions given that the former are most often targeted in shareholder class actions² (with officers sometime added as defendants) and appear to be significant funders of settlements.³

This submission acknowledges the legitimate policy objectives of an elected government and genuine concern as to the appropriate balance between plaintiffs and defendants in shareholder class actions. It also gives some weight to certain other principles or objectives including:

1. Legal coherence and consistency
2. Conceptual clarity and consistency
3. Policy clarity and consistency
4. Precedent

The submission deals with continuous disclosure changes and misleading and deceptive conduct changes separately and comes to somewhat different conclusions on each.

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² M Duffy, 'Australian private securities class actions and public interest - assessing the 'private attorney-general' by reference to the rationales of public enforcement' (2017) 32(2) *Australian Journal of Corporate Law* 162.

³ M Duffy, 'Protection of Companies from Shareholder Class Actions Through Constitutional Amendment: Is This Possible or Desirable?' (2011) 23(1) *Bond Law Review* 1, 17.

CONTINUOUS DISCLOSURE

1. The objective and/or effect of the changes appears to be that
 - a. the former continuous disclosure contravention remains as an offence but is no longer a civil penalty provision while;
 - b. a new form of continuous disclosure contravention, involving knowledge, recklessness or negligence is enacted and is a financial services civil penalty provision (entailing a right to compensation) but not an offence.

Continuous disclosure breaches as a civil penalty provision

The nature of civil penalty provisions

2. One of the earliest descriptions of the nature of civil penalties and policy rationales therefore was given in the Senate debate on the Trade Practices Bill in the 1970s by the then Attorney-General. In relation to the civil penalties relating to the trade practices or competition aspect of the bill he noted:

The nature of the penal provisions are such as to create what are called civil offences rather than criminal offences ... We think it is important not to import into the trade practices area the notion of criminality as such Inevitably, if the Opposition is successful in its bid to include in the clause the phrase 'beyond reasonable doubt', businessmen who are caught up by these provisions will be treated as criminal'⁴

3. In 1992 the then Federal Attorney-General, stated in his second reading speech on the Corporate Law Reform Bill 1992:

The Bill also provides that where a director breaches his or her duty, but is not acting with any dishonest or fraudulent intent, the director should no longer be exposed to criminal sanctions and possible gaol terms. But it also says that shareholders should be protected against breaches by the substitution of appropriate civil penalties, including pecuniary penalties and disqualification in the case of serious breaches.⁵

4. These parliamentary statements suggest that civil penalties are intended to be less 'penal' than criminal penalties. By the same token there appears also to have been an expectation that they might be imposed more frequently given the lower standard of proof and less serious sanctions (such as imprisonment not being available).⁶
5. The Australian Law Reform Commission (ALRC) has summarised the nature of civil penalties:

Civil penalty provisions are founded on the notion of preventing or punishing public harm. The contravention itself may be similar to a criminal offence and may involve the same or similar conduct, and the purpose of imposing a penalty may be to punish the offender, but the procedure by which the offender is sanctioned is

⁴ Parliamentary Debates - Senate, vol 61 15 August 1974 at 951-5.

⁵ Parliamentary Debates - House of Representatives, Weekly Hansard, No 15, 3 November 1992 at 2400.

⁶ Michael Gillooly and Nii Lante Wallace-Bruce, 'Civil Penalties in Australian Legislation' (1994) 13(2) *University of Tasmania Law Review* 269, 270

based on civil court processes. Civil monetary penalties play a key role in regulation as they may be sufficiently serious to act as a deterrent (if imposed at a high enough level) but do not carry the stigma of a criminal conviction. Civil penalties may be more severe than criminal penalties in many cases.⁷

6. In the leading Corporations Law text, Ford, Austin and Ramsay similarly note that civil penalties were recommended by reformers who thought that directors and those who contravene the Corporations Act should not be branded as criminals unless they acted dishonestly⁸ and consistent with this, an honesty defence is provided under s1317S. Dishonesty on the one hand and intent and knowledge on the other are somewhat related however, though dishonesty will usually involve intent or knowledge, it is not necessarily the case that intent or knowledge will always involve dishonesty.
7. Ford Austin and Ramsay further note that civil penalties are designed to provide an additional or alternative enforcement option ‘where there may be difficulty in proving the necessary fault element to establish a criminal offence’.⁹

The requirement of fault in criminal liability

8. A mental element or ‘*mens rea*’ has traditionally been part of criminal offences and this traditionally consisted of intent, knowledge or recklessness in relation to the commission of an offence. Since 1995 the *Criminal Code*¹⁰ has applied to offences in Commonwealth legislation or common law. Its purpose was ‘to codify the general principles of criminal responsibility under the laws of the Commonwealth’ (part 2.1) to ensure that the same principles of criminal responsibility would apply to all Commonwealth offences. It contains all the general principles of criminal responsibility that apply to any offence, irrespective of how the offence is created (part 2.1).
9. The *Criminal Code* includes the traditional common law forms of *mens rea* (intent, knowledge or recklessness), but also adds negligence as a fault element (though not all commentators necessarily endorse the logic of this¹¹).
10. Thus (as noted by the ALRC¹²) under the *Criminal Code*, fault is an element of a criminal offence unless specifically excluded. Nevertheless, fault has not universally been an element of all criminal offences because of the existence of some criminal offences of strict and absolute liability do not require proof of fault. Thus, while the necessity to prove *mens rea* may have been true of common law crimes, it is not true of all statutory offences.¹³

⁷ ALRC, *For Your Information: Australian Privacy Law and Practice* (ALRC Report 108) August 2008 [71.85].

⁸ Austin and Ramsay, *Ford, Austin and Ramsay’s Principles of Corporations Law* (16th edition 2015) Lexisnexis [3.390].

⁹ *Ibid*

¹⁰ *Criminal Code 1995* (Cth) and *Criminal Code Act 1995* (Cth).

¹¹ Ian Leader-Elliott has suggested that, in formulating the Code, ‘liability for negligence was accepted, at best, as an expedient compromise of fundamental principle’. See Ian Leader-Elliott, ‘Elements of Liability in the Commonwealth Criminal Code’ (2002) 26(1) *Criminal Law Journal* 28, 37.

¹² ALRC, *Securing Compliance: Civil and Administrative Penalties in Federal Jurisdiction* (Discussion Paper 65) May 2002 [17.46]

¹³ The ALRC cites D Brown and others, *Criminal Laws: Materials and Commentary on Criminal Law and Process in New South Wales* (1996) Federation Press, Sydney, 326.).

11. Until 1999 the *Corporations Law* contained the former s1317FA (1) which provided that a person was guilty of a (criminal) offence if the person contravened a civil penalty provision: (a) knowingly, intentionally or recklessly; and (b) either: (i) dishonestly and intending to gain, whether directly or indirectly, an advantage for that or any other person; or (ii) intending to deceive or defraud someone. After removal, the criminal consequences of breaches are dealt with, where applicable in the particular civil penalty provisions themselves.

Fault – criminal and civil

12. As noted by the ALRC in 2002¹⁴ the need to prove fault, or the mental element, is usually an important difference between criminal and civil contraventions, with criminal proceedings generally requiring proof of the mental element making up the offence together with the relevant physical element (the physical element being the action by the defendant itself traditionally known as the *actus reus*).
13. Provisions in some acts provide for both criminal and civil penalties for the same conduct. When this occurs acts often provide that there is a bar against civil penalty proceedings for a contravention following conviction for an offence constituted by conduct that is substantially the same.
14. Examples of this are s486A of the *Environment Protection and Biodiversity Conservation Act 1999* (Cth) and s1317M *Corporations Act 2001* (Cth). There are a number of provisions in the *Corporations Act* that can be prosecuted criminally or as a civil penalty such as directors' duties (ss182,183,184) and insider trading (S1043A).
15. Yet it is not the case that no civil penalty offences require a fault element even when prosecuted for civil penalty rather than criminal liability. Examples are:
 - a. Section 494(1) of the *Environment Protection and Biodiversity Conservation Act 1999* (Cth) which provides for civil penalties for executive officers of corporate bodies that contravene a civil penalty provision when it can be shown, inter alia, that 'an executive officer of the body knew that, or was reckless or negligent as to whether, the contravention would occur'.
 - b. Sections 12 and 13 the *Sydney Airport Demand Management Act 1997* (Cth) provide that the operator of an aircraft is liable for a civil penalty for a 'no slot' or 'off-slot movement' only if this is done 'knowingly or recklessly'.
16. In its discussion paper on Federal Civil and Administrative Penalties in Australia¹⁵ the ALRC initially did not favour a role for fault elements in civil penalty proceedings, at least where parallel or sequential civil penalty (non-criminal) and criminal proceedings were both possible (proposal 17-2, [17.52]) however in its final report¹⁶ it said that fault elements do properly have a role to play in some contraventions leading to civil penalties.¹⁷

¹⁴ ALRC, *Securing Compliance: Civil and Administrative Penalties in Federal Jurisdiction* (Discussion Paper 65) May 2002.

¹⁵ Ibid

¹⁶ ALRC, *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95) March 2003.

¹⁷ Ibid [4.66]

17. The ‘penal’ aspect of civil penalties (i.e. that they involve the state ‘punishing’ a citizen) seems to have had more influence on the development of *procedural protections* for defendants (such as penalty privilege against self-incrimination) than it has on the question of *showing fault of that citizen*. Thus, the ALRC acknowledged that the more a penalty is seen as having punitive and retributive elements, the more the courts will seek, with good reason, to insist on criminal *procedural* protections at least such as the privilege against self-incrimination (see discussion of *Rich v ASIC* (2004) 220 CLR 129 below).¹⁸
18. In relation to fault where the main remedy is compensation, the ALRC noted in its discussion paper that if the aim of a penalty was ultimately to compensate loss or to require a disgorgement of profits, there should be less concern about *procedural* protections such as the privilege against self-incrimination.¹⁹ On the other hand, in another civil context (namely, the suggestion of creation of a tort for serious invasions of privacy in the digital era), the ALRC has more recently argued that ‘fault is a key element in any cause of action leading to personal liability to pay compensation for loss or damage caused to another person’²⁰

ASIC v Rich and penalty privilege

19. In *Rich v ASIC* (2004) 220 CLR 129 the High Court held that a form of penalty privilege (under which a defendant was not required to give pre-trial discovery of documents²¹) was available in an action seeking an order disqualifying him from being a director. This was subsequently partly reversed by legislation (s1349 *Corporations Act*) but may raise a general illustration of the reluctance of courts to not erode traditional rights unless specifically abrogated by the legislature (this obviously does not relate in any way specifically to the need to show a defendant’s fault in relation to an offence though nevertheless gives a flavour of a possible general traditional concern of courts with fairness and defendant rights).
20. In an article written in 1994²² on civil penalties, Gillooly and Wallace Bruce compared their operation in respect of the former *Trade Practices Act 1974*, *Industrial Relations Act 1988* and *Corporations Law*. The article focused principally on the nature of civil penalties (as compared to pure criminal or pure civil liability) in relation to:
- a. procedure - such as whether criminal or civil procedure is applicable and whether a defendant to a civil penalty action has ‘penalty privilege’ (as later discussed in *Rich*)
 - b. standard of proof - such as whether the higher criminal standard - ‘beyond reasonable doubt’ - or the lower civil standard - ‘on the balance of probabilities’ – is required;
 - c. sanctions – noting that custodial penalties (imprisonment) are reserved for criminal matters only.

¹⁸ Ibid [17.57]

¹⁹ Ibid.

²⁰ ALRC, *Serious Invasions of Privacy in the Digital Era* (Discussion Paper 80) March 2014 [5.60]

²¹ Which documents might conceivably harm a defendant’s case and thereby expose a defendant to penalty.

²² Michael Gillooly and Nii Lante Wallace-Bruce, ‘Civil Penalties in Australian Legislation’ (1994) 13(2) *University of Tasmania Law Review* 269.

21. There was little discussion in the article of the question of fault elements in criminal and civil penalty actions. The authors noted that, in the absence of proof of *mens rea* a person who contravened a civil penalty provision was not guilty of a criminal offence, but was nevertheless liable to have civil penalty orders made against them – though they noted in a footnote that proof of some mental element may be necessary for a contravention of the provision, citing *Chew v R*.²³ Apart from this however, the authors made no suggestion that the civil penalty actions in any of the areas of Trade Practices, or Corporations then required a fault element.
22. In the more specific debate about shareholder class actions based on a failure to make continuous disclosure, the question of the ‘seriousness’ of the misconduct in question has been raised.²⁴ In that regard, loss and damage to individual investors as well as overall damage to the economy through resource misallocation by inefficient securities markets has been noted from the economic perspective.²⁵ The jurisprudential question of ‘seriousness’ however may also raise the question of how intentional the misconduct is or whether it is otherwise morally blameworthy through being careless or involving inattentiveness to duty.²⁶
23. It can also be noted that the original version of the continuous disclosure provisions did require intention, recklessness or negligence. As noted by Lindgren J in *Australian Securities and Investments Commission v Southcorp Limited*, an important difference between the present Ch 6CA and the former ss 1001A-1001D was that ‘the requirement of intentionality, recklessness or negligence has not been retained’²⁷.
24. In that regard it can be noted though that the new drafting is different to this older drafting and, with respect is less clear, and somewhat confusing. As noted by the submitter in an article published the *Company and Securities Law Journal* in 2021,²⁸ the proposed changes appear to seek to embed the concepts of knowledge, recklessness or negligence in the statutory definition of materiality itself (though note that the

²³ *Chew v R* (1992) 7 ACSR 481 in which the High Court decided that, for a contravention of s 229(4) of the Companies Code (somewhat similar to today’s s182 of the *Corporations Act*) to be established, proof of an intent to gain an advantage or cause a detriment is necessary.

²⁴ Michael Duffy, ‘Australian private securities class actions and public interest - assessing the ‘private attorney-general’ by reference to the rationales of public enforcement’ (2017) 32(2) *Australian Journal of Corporate Law* 162, 170, 187-189.

²⁵ *Ibid* 162

²⁶ *Ibid* 187-189

²⁷ *Australian Securities and Investments Commission v Southcorp Limited* (No 2) (2003) 48 ACSR 187, 189 (though an element of knowledge is still likely to be required for persons ‘involved’ in the contravention). Note that the former s1001A provided as in part as follows:

(2) The disclosing entity must not contravene those provisions by intentionally, recklessly or negligently failing to notify the securities exchange of information:

(a) that is not generally available; and

(b) 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.

(3) A contravention of subsection (2) is only an offence if the failure concerned is intentional or reckless.

As to the interpretation of the former s1001A (2) see *Jubilee Mines NL v Riley* (2009) 40 WAR 299, particularly 318-319 [69]-[72].

²⁸ Michael Duffy, ‘Modifications to continuous disclosure requirements and the role of corporate knowledge, intent, recklessness and negligence in breaches: a discussion (2021) 38(2) *Company and Securities Law Journal* 138.

changes do not alter the definition of materiality in the Listing Rules).²⁹ In doing so, it is submitted respectfully that this may conflate issues of materiality with issues of liability in a somewhat confusing manner, and in particular:

- a. it may create conceptual confusion in that materiality of information is no longer an objective fact or test but is somewhat tied up with the entity's own knowledge or behaviour;
- b. there may be also be some confusion arising from a different definition of materiality in the Listing Rules and the legislation;
- c. on a literal reading, if the conjunction 'whether' is interpreted in its usual meaning of 'whether or not', the changes might literally require disclosure whether the information is objectively material or not since the test is knowledge, recklessness or negligence as to whether or not it is material, rather than as to the fact of it being actually material – two different things (though this obviously would not seem to be the intention of the changes);
- d. it also decouples the definition of materiality for continuous disclosure from the previously identical definition of 'inside information' or materiality for insider trading in s1042A.

The particular situation of corporations

25. Establishing fault in relation to corporations has particular difficulties insofar as intent, knowledge, recklessness or negligence of the company must be squared with the nature of the corporate legal person and its 'directing mind and will'. The 'directing mind and will' doctrine ascribes corporate knowledge mainly to the board and senior management insofar as they are responsible for the transaction in question;³⁰ yet it also contemplates possible delegation of the mind of the corporation by the board to others within the corporation if the latter are given full discretion and autonomy in relation to a particular transaction.³¹ Of particular relevance are rules of attribution under which the acts and knowledge of persons who cannot be identified to be the directing mind and will, can be attributed to the company on the basis of agency or legislative intent.³²
26. It might also be noted that in the criminal sphere at least, the *Criminal Code*, provides that a corporation's culture might also play a part in these issues – insofar as it expressly, tacitly or impliedly authorises or permits the commission of an offence.³³
27. Another factor to consider is that, unlike natural persons, corporations have no privilege against self-incrimination in a civil penalty action so that procedural protections that

²⁹ Professor Spender has made the same point in a submission to the earlier PJC enquiry noting 'Further, the law itself is in disarray as a result of the changes. The Coronavirus Determination amended Section 674 of the Corporations Act to replace the reasonable person standard with a new temporary test of whether the entity knows, or was reckless or negligent with respect to the information. However, the s 674 obligation is based on an underlying obligation to the market, e.g. in ASX Listing Rule 3.1, which uses the reasonable person test. At the time of writing the ASX has not changed its Listing Rules so there are two inconsistent tests operating on the same disclosure obligation. Submission 50 to Parliamentary Joint Committee on Corporations and Financial Services, *Litigation funding and the regulation of the class action industry*.' https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Litigation_funding/Submissions

³⁰ See generally *Tesco Supermarkets Ltd v Natrass* [1972] AC 153

³¹ *Ibid* 170-171

³² Austin and Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* (16th ed, Butterworths 2015) [16.180]

³³ *Criminal Code* s12.3

might be applied to individuals are not available to corporations.³⁴ This is advantageous to regulators and plaintiffs if they take action against corporations alone, but disadvantageous to defendant corporations (and their shareholders insofar as this exposes them more to liability payouts).

28. A relevant factor in the debate over continuous disclosure may also be that current interpretations of the notion of a company being ‘aware’ of information may also be seen as somewhat advantageous to regulators or plaintiffs. To be required to disclose information a company must be aware of that information however, for various reasons (mainly to do with the definition of awareness in ASX Listing Rule 19.12) ‘awareness’ appears to include not only information that a company knows but what it ‘should have’ been aware of.³⁵ This may appear to negate the need to prove actual awareness of information by the company, prior to showing that it did not disclose. This is, on one view, a separate issue, but is also somewhat bound up with the issues of knowledge and negligence embodied in the proposed changes.

Conclusions

29. Requiring fault elements in civil penalty provisions is unusual but not unheard of. The case for this is perhaps not overly strong doctrinally, given the difference in nature between civil penalty and criminal action, however it is probably not untenable given the partly ‘penal’ nature of civil penalties. Common law courts have tended to protect rights from unfair penalties by focusing on procedural protections for defendants (rather than requiring fault elements) such as penalty privilege however this is of no benefit when the defendant is a corporation as the corporation has no such right. The case for ‘fault’ elements in civil penalties, though not overwhelming, is comparatively stronger than the very problematic case for including ‘fault’ in purely civil actions for misleading and deceptive conduct which I will now discuss.

MISLEADING AND DECEPTIVE CONDUCT

30. The objective and/or effect of the changes to s1041H and s12DA appears to be to introduce the same fault elements where misleading or deceptive conduct claims are brought on the basis of the same conduct as continuous disclosure breaches.
31. At the outset it should be remarked that the drafting of the proposed laws is not without considerable ambiguity. If enacted it is unclear how the changes might apply in practice. For instance, when active misleading disclosures are constituted by half-truths or incomplete statements – made up of positive statements that do not mention matters that should have been disclosed or caveats that should have been given – they appear to infringe s1041H but arguably also partly (though not fully) involve nondisclosures. Does this mean that knowledge, recklessness or negligence will be partly required (for part of the statement) and partly not? This may be somewhat nonsensical.

³⁴ *TPC v Abbco Ice Works Pty Ltd* (1994) 52 FCR 96.

³⁵ This issue is discussed more fulsomely in Michael Duffy, ‘Modifications to continuous disclosure requirements and the role of corporate knowledge, intent, recklessness and negligence in breaches: a discussion (2021) 38(2) *Company and Securities Law Journal* 138.

32. It is submitted for this reason and for the foregoing reasons that this change is significantly more problematic than the above changes in relation to civil penalties for continuous disclosure breaches and is an undesirable change.
33. S1041H and s12DA have their origins and antecedents in statutory provisions proscribing misleading and deceptive conduct in trade or commerce established in Australia nearly 50 years ago in s52 of the *Trade Practices Act 1974* (Cth). Misleading and deceptive conduct in relation to financial services was carved out of the *Trade Practices Act* in the late 1990s and re-enacted in the *Corporations Law*, for a time as s995 in relation to securities and later becoming s1041H of the *Corporations Act* and s12DA of the *ASIC Act 2001* (Cth) (the provisions or their basic concepts have also found their way into various other laws³⁶).
34. There is almost 50 years of jurisprudence in relation to the meaning of ‘misleading and deceptive conduct or conduct likely to mislead or deceive’ going back to its original incarnation in s52. This jurisprudence is generally applicable to s1041H.³⁷
35. The provision has never required fault elements, with the High Court confirming in 1978 that if conduct is misleading or deceptive it is unnecessary for a corporation to have any intention to mislead or deceive or to have any dishonest belief in order for the section to be contravened. a trader could breach that provision without an intent to do so.³⁸
36. Further, it appears that carelessness has also never been a requirement for liability under this provision (carelessness being a concept somewhat related to recklessness and even more closely related to negligence).³⁹ Indeed it is said that a corporation may breach the provision despite the fact that a representation is made honestly, innocently and without any intention to actively mislead or deceive.⁴⁰
37. Misleading and deceptive conduct is said to be more ‘concerned with consequences’⁴¹ once it is shown that a defendant has led others into error. It has been said that the general approach to the construction of the provisions is that they are to be treated by the courts as a fundamental piece of remedial and protective legislation which gives effect to matters of high policy and is therefore to be construed so as to give the fullest relief which the fair meaning of its language will allow.⁴²

³⁶ They appeared in state Fair Trading Acts as well as in various Commonwealth Acts: See *Australian Consumer Law* (s18), *Competition and Consumer Act 2010* (Cth) (ss56BN, 56BO), *Education Services for Overseas Students Act 2000* (Cth) (s15), *Wine Australia Act 2013* (Cth) (s40F), *Bankruptcy Act 1966* (Cth) (s148), *National Measurement Act 1960* (Cth) and *Referendum (Machinery Provisions) Act 1984* (s122). In addition, the slightly more serious (usually quasi criminal) concept of false or misleading information appears in many Commonwealth Acts.

³⁷ Austin and Ramsay [22.452]

³⁸ *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216. See also *Parkdale Custom Built Furniture Pty Ltd v Puxu* (1982) CLR 216.

³⁹ *Re Gordon Douglas Neilsen v Hempston Holdings Pty Ltd; Stella Jean Cheffers* [1986] FCA 100 (1986) 65 ALR 302 [29] Pinkus J

⁴⁰ Ray Steinwall, *Annotated Trade Practices Act 1974* (2009 edition Lexisnexis) 10,945.165

⁴¹ *Hornsby* per Stephen J at 647

⁴² Austin and Ramsay noting *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 496 [99] per Gummow J

38. One of the reasons that fault has never been a required part of the provisions may have to do partly with origins in trade practices and economic law where wrong information, in addition to damaging individuals, is fatal to the efficient functioning of private markets so that its elimination is a critical priority. This is not to say however that the provisions were at odds with jurisprudential notions or the common law or equity when enacted in 1974. The concept of innocent misrepresentation pre-dated the provisions and in contract at least this had often allowed rescission (if not damages) in equity.⁴³
39. Another important factor is that s1041H is a purely civil remedy rather than a civil penalty remedy so that the requirement of fault, which can be an important shield for a citizen when the state seeks to impose a punishment, is not part of the equation.
40. Lastly, the nature of positive action causing loss (by misleading conduct) also appears to be subtly different to the notion of inaction causing loss (failure to disclose). The person or entity who hurts another – regardless of intent – will tend rightly to attract more criticism compared to the person or entity that fails to prevent hurt to another. The former is rightly penalised but if the latter is to be penalised also, then fault may be a more legitimate enquiry. The corollary though is that fault should be a much less critical question in the former case (s1041H), especially if the aim is to generally discourage actors doing things to actively cause loss.

Conclusions

41. The proposed changes to the purely civil misleading and deceptive conduct provisions in s1041H and s12DA are potentially unclear and confusing and also seem to fly in the face of nearly fifty years of jurisprudence about misleading and deceptive conduct.

Other observations and overseas precedent

42. The changes appear to come from a perception (correct or incorrect) that, through good lawyering, willing litigation funders and the effects of class action procedural machinery, it has become too easy and too profitable for plaintiff lawyers, funders and a group of current or former shareholders to obtain (mostly by way of out of court settlement⁴⁴) eight and nine figure sums from medium and large listed corporations (and their shareholders). This can occur where, for whatever reason, corporations fail to make swift and comprehensive disclosure of information which they are aware of or should be aware of. The phenomenon of multiple shareholder class actions competing for the right to be run hints at the profitability of such litigation.
43. The counter argument is that recent extensive changes to tighten regulation of litigation funding and these changes to continuous disclosure and misleading and deceptive conduct laws may ‘throw the baby out with the bath water’ in making such claims substantially more difficult and expensive to prosecute. This could see private enforcement of securities disclosure substantially lapse so that it may similarly become too easy for corporations to have lax or inadequate disclosure practices that ignore the rights of investors investing substantial sums on the basis of what companies say about

⁴³ J W Carter and D J Harland, *Contract Law in Australia* (2nd edition Butterworths 1991) [1138] citing *Reese River Silver Mining Co v Smith* (1869) LR 4 HL 64 per Lord Cairns.

⁴⁴ Nearly all shareholder class actions settle out of court. An exception was *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747 which went to full judgment.

themselves. Poor disclosure and misinformed stock markets could become more prevalent, leaving ASIC alone in the field and investors generally uncompensated.⁴⁵

44. This is the debate and both sides may have a point. The task is to get the balance right and the debate is not unique to Australia. The response to similar arguments and perceptions in the United States and Canada can be instructive.

United States

45. The US developed shareholder class actions well before Australia and these have been a feature of US securities markets for decades. A backlash by corporate business to such suits saw the *Private Securities Litigation Reform Act*⁴⁶ enacted in 1995. It contained several substantive changes to actions brought under the US securities laws. These included changes relating to class representation, pleading, discovery and lawyers' fees. In relation to the first two, judges could henceforth decide the most adequate plaintiff in class actions. One of the requirements was that the plaintiff had a sufficiently large financial interest to represent the class with a presumption in favour of the shareholder with the largest financial interest. The purpose of this provision was to stop the use of 'straw men' with small claims acting as lead plaintiffs in claims that were really 'lawyer driven' and orchestrated. It was also intended to stop the 'race to the courthouse' under which the plaintiff and his attorney who filed first would be the plaintiff and class counsel for the proceeding.⁴⁷
46. The PSLRA also heightened the requirements for pleading of securities actions in three ways. Firstly, it required that allegedly false statements be pleaded with particularity so that they alleged the reason why statements were said to be misleading and the facts in support of that allegation. Secondly there was a requirement that the plaintiff alleged that the defendant acted with the required state of mind in knowing that the statement was false or was reckless as to its falsity (claims under the US Rule 10b-5 require the plaintiff to prove that the defendant acted with intent to deceive, manipulate or defraud – known as 'scienter').⁴⁸ Lastly there was a requirement that a plaintiff would have the burden of proving that the act or omission of the defendant alleged caused the loss for which the plaintiff sought to recover damages.⁴⁹ The US Supreme Court's decision in

⁴⁵ ASIC's most popular enforcement weapon in this area appears to be the infringement notice and fine, followed by civil penalty action against companies and persons those involved, with compensation claims for shareholders fairly rare (ASIC presumably has mostly left the latter field to private enforcement though did seek compensation in the Multiplex litigation).

⁴⁶ Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.).

⁴⁷ 'The PSLRA, according to its legislative history, was enacted in response to perceived abuses of federal securities class actions through which a race to the courthouse often resulted in non-representative plaintiffs and their attorneys controlling the litigation and reaping disproportionate fee awards at the end of the case' *California Public Employees' Retirement System v. The Chubb Corp.*, 127 F.Supp.2d 572, 575, [2000-2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,299 (D.N.J. 2001), relying on *In re Lucent Technologies, Inc., Securities Litigation*, 194 F.R.D. 137, 144 (D.N.J.2000);

⁴⁸ In *Tellabs, Inc. v. Makor* (June 21, 2007) the Supreme Court examined the requirement that plaintiffs plead with particularity facts giving rise to a "strong inference" of scienter. The Seventh Circuit Court had interpreted the language to require the pleading of facts "from which, if true, a reasonable person could infer that the defendant acted with the required intent." 437 F. 3d 588, 602 (2006). This was rejected by the Supreme Court in an 8-1 opinion. Justice Ginsburg on behalf of the majority found that "an inference of scienter must be more than merely plausible or reasonable, it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent."

⁴⁹ 15 U.S.C. § 78u-4(b)(4).

*Dura Pharmaceuticals Inc v Broudo*⁵⁰ would make it clear that this meant that loss causation must be adequately alleged at the pleading stage.⁵¹

Canada

47. Canada, like Australia, developed comprehensive statutory procedures to facilitate shareholder and other class actions some time later than the United States (though these developed at a provincial rather than a national level in Canada).⁵²
48. The laws appear to provide benefits to both plaintiffs and defendants.⁵³
49. For plaintiffs, this has included introducing statutory presumed causation whereby plaintiffs do not need to prove that investors relied on misrepresentations to establish a right to recover loss. The *Securities Act*⁵⁴ of Ontario enacted in 1990 provided that purchasers who purchased a security offered under a prospectus containing a misrepresentation during the period of distribution ‘shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase.’⁵⁵ This applied also to takeover bid circulars sent to security holders which contained a misrepresentation⁵⁶ and 2002 amendments gave persons or companies who acquire or dispose of shares during the currency of a misrepresentation a right of action for damages against various people without regard to whether the investor relied on the misrepresentation.⁵⁷ Those against whom damages could be claimed included the issuer company, its officers, influential persons who influenced the company in making the misrepresentation and experts. Similar provisions applied to statements made by influential persons or their agents and to failures by the company to make timely disclosure (s138.3(4)).⁵⁸ In the last case the presumption allowed persons or companies to sue ‘without regard to whether the person or company relied on the responsible issuer having complied with its disclosure requirements.’⁵⁹

⁵⁰ 125 S.Ct. 1627 (2005).

⁵¹ Please note that this section is mainly based on research of a few years ago – in the time frame available for this submission I have not been able to check the current situation in the US and I am assuming these laws will not have been extensively altered.

⁵² The first province to introduce class action legislation was Quebec in 1978 (*Class action, An Act respecting the*, R.S.Q. c. R-2.1). Ontario followed in 1992 (*Class Proceedings Act*, 1992, S.O. 1992, c. 6), British Columbia in 1996 (*Class Proceedings Act*, R.S.B.C. 1996, c. 50), Saskatchewan in 2001 (*Class Actions Act*, S.S. 2001, c. C-12.01), Newfoundland in 2001 (*Class Actions Act*, S.N.L. 2001, c. C-18.1), Manitoba in 2002 (*Class Proceedings Act*, C.C.S.M. c. C130), Alberta in 2003 (*Class Proceedings Act*, S.A. 2003, c. C-16.5) and New Brunswick in 2006 (*Class Proceedings Act*, S.N.B. 2006, c. C-5.15). Federal procedures were created in 2002 under the *Federal Court Rules* SOR/98-106.

⁵³ Please note that this section is mainly based on research of a few years ago – in the time frame available for this submission I have not been able to check the current situation in Canada and I am assuming these laws will not have been extensively altered.

⁵⁴ R.S.O. 1990, c. S.5

⁵⁵ Ibid s130

⁵⁶ Ibid s131. As can be seen, the sections focus on “misrepresentation” (as opposed to the Australian “misleading or deceptive” representation or conduct). Misrepresentation is defined under the interpretation section contained in s1(1) of the Ontario *Securities Act* to mean “(a) an untrue statement of material fact, or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made; (‘présentation inexacte des faits’).” See R.S.O. 1990, c. S.5 s1(1).

⁵⁷ Ibid s138.3(1) and (2)

⁵⁸ The “timely disclosure” provision is in addition to but perhaps overlaps with the older Continuous Disclosure provision in section 75(1) of that Act which provides that “where a material change occurs in the affairs of a reporting issuer, it shall forthwith issue and file a news release authorized by a senior officer disclosing the nature and substance of the change.” (R.S.O. 1990, c. S.5, s. 75 (1); 1994, c. 11, s. 349).

⁵⁹ R.S.O. 1990, c. S.5, S138.3(4)

50. The legislation distinguished between ‘core documents’ on the one hand and ‘non-core documents’ and verbal statements on the other. The former include a prospectus and circulars in relation to take-over bids, issuer bids (buybacks) or rights offerings, management analysis, annual information form, information circular, annual or interim financial statements.⁶⁰ In core documents liability was imposed unless a due diligence defence was established.⁶¹ In non-core documents, a plaintiff would need to show knowledge of falsity or gross misconduct.⁶² There was also a defence if the defendant can prove that the plaintiff knew of the falsity of a representation.⁶³
51. For defendants, the laws included threshold requirements of the need for plaintiffs to establish both ‘good faith’ and ‘substantive merits’.⁶⁴ This required that the plaintiff produce evidence to satisfy the court of such good faith and of a reasonable possibility that the action will be resolved at trial in favour of the plaintiff (and that such evidence be produced before the plaintiff has had the benefit of obtaining discovery of documents from the defendants). This was in addition to the threshold hurdles for certification of the class under class action legislation.⁶⁵
52. The laws also placed a cap on damages for ‘unknowing’ conduct.⁶⁶ The cap for damages payable by the issuer company is the greater of 5 per cent of the issuer company’s market capitalization or \$1 million. But the caps would not apply where a person made a misrepresentation or nondisclosure with knowledge that it was a misrepresentation or nondisclosure.⁶⁷

⁶⁰ R.S.O. 1990, c. S.5, S138.1

⁶¹ Such as proof of the undertaking of reasonable investigations [R.S.O. 1990, c. S.5, S138.4(6)].

⁶² R.S.O. 1990, c. S.5, S138.4

⁶³ R.S.O. 1990, c. S.5, S138.4(5)

⁶⁴ S138.8 (1) RSO 1990, c S-5

⁶⁵ S5 of the *Class Proceedings Act* RSO 1992 C6. These relate to showing common issues, an identifiable class, that the class proceeding is the preferable procedure and that the plaintiff adequately represents the class. See Peter Cashman, *Class Action Law and Practice* Federation Press 2007 p645.

⁶⁶ Sections 138.1 and 138.7.

⁶⁷ S138.5-138.7, RSO 1990, c S-5. There are also various other caps in S138.1 for directors, influential persons and experts.

Annexure A

Submitter's background

The submitter's background is:

He has been an academic since 2007 and has published extensively in peer reviewed journals on ASIC law, company and shareholder law, class actions and access to civil justice and regulation of quasi (or actual) financial products such as litigation funding and digital currency as well as constitutional law.

He is a lawyer and, before joining Monash, was a Solicitor at Mahony & Galvin (1989-1992) and Senior Associate at Macpherson & Kelley (1992-1999) and Maurice Blackburn Cashman (1999-2004) and a Senior Lawyer with the Australian Securities and Investments Commission (2004-2007). He spent ten years in general commercial litigation acting for plaintiffs and defendants then four years as a plaintiff lawyer on a team acting for the lead plaintiffs in Australia's first major successful shareholder class action (*King v GIO*). He was also instructing solicitor on one of the earliest and few investor class actions to go to successful judgment for the plaintiffs (*Spangaro v CIAFM*). At ASIC he worked as a senior enforcement lawyer working on matters including corporate investigation and liquidation, continuous disclosure, insider trading, managed investment schemes and financial services.

He was accredited by the Law Institute as a commercial litigation specialist from 1997 through 2007.

He has consulted to the private sector in relation to managed investment schemes and the structure of representative proceedings. He has also received funding from the private profession to research access to justice issues, takeover law in proprietary companies and public interest relief in shareholder class actions.

He holds bachelor degrees in Law and Commerce and a Masters in Law from the University of Melbourne and a PhD from Monash for his thesis examining the extent to which private securities class actions can provide investor protection from poor securities disclosure, including a comparison with ASIC enforcement in the area.