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Business Council of Australia

Treasury Laws Amendment (2021 Measures No. 1) Bill 2021

Submission to the Senate Legislation Committee on Economics

March 2021

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Overview

This is the Business Council of Australia's submission to the Senate Legislation Committee on Economics on the provisions of the *Treasury Laws Amendment (2021 Measures No. 1) Bill 2021* (the Bill). The Bill will make a number of targeted and measured amendments to the *Corporations Act 2001* (the Act), to prolong the operation of reforms to continuous disclosure rules and arrangements relating to virtual meetings and the electronic execution of documents that were implemented on a temporary basis in 2020.

The need to pass the Bill urgently

The Business Council strongly supports all measures in the Bill and recommends its swift passage by the Parliament. The measures in the Bill are all time-sensitive and should be passed by the end of March 2021, to coincide with the end of the temporary measures that are due to expire at that time.

The initial timeline for the Committee's inquiry required it to report by Friday 12 March. This would have enabled the Senate to pass the Bill in a timely way. On 25 February the Senate voted to extend the reporting date to 30 June. The reasons for this change are not clear. It will have significant adverse consequences for business, who will now be forced to revert to the pre-COVID rules relating to meetings and disclosures once the temporary measures expire. This will be particularly problematic for those businesses that had anticipated being able to hold virtual Annual General Meetings but will now be forced to hold such meets in person. In certain cases, this may not be physically possible, given that they may still be subject to COVID-19 limits on the size of physical gatherings.

Given these immediate and pressing problems, the Business Council strongly encourages the Senate to re-consider its decision to extend the reporting date by over three months. We also note that the decision of the Senate on 25 February did not extend the closing date for submission on the Bill, which remained Monday 1 March. This will still give the Committee and the Senate sufficient opportunity to consider the Bill prior to the expiry of the temporary measures. In addition, the reforms in the Bill have already been able to be considered in some detail, as a result of the consultation process on draft legislation conducted by the Government in 2020, and during the operation of the temporary measures that the Bill would make permanent.

If this is not possible, the Business Council strongly encourages the Government and the Parliament to consider measures that would enable the Treasurer to extend the existing temporary arrangements until such time as the Bill can be dealt with by the Senate.

Recommended amendments

This submission proposes several targeted amendments to the Bill that will improve the workability of its measures and better enhance its benefits for business and shareholders, as follows:

1. Electronic execution of documents – Make clear that that a copy or counterpart to be signed does not need to include the entire document, and that there is no need for a separate original when a copy or counterpart is being signed.
2. Electronic execution of documents - Extend the provisions to foreign and statutory corporations.
3. Continuous disclosure – Amend the proposed section 674A so that the provision is only contravened if the listed entity's failure to comply is intentional, reckless or negligent, rather than the current drafting, which ties the requirement for actual knowledge, recklessness or negligence to the effect of information on the market. The recommended amendment better reflects the intention of the Bill to ensure that, in determining whether a listed disclosing entity contravenes its existing continuous disclosure obligations, its state of mind is taken into account.

4. Continuous disclosure – As drafted, the Bill retains the existing section 674 (which does not take into account whether the entity has knowledge or has been reckless or negligent) as a strict liability offence. If section 674 is to be retained, the due diligence defence in section 674(2B), which has been omitted by the Bill, should be re-inserted in section 674 for the benefit of the entity itself.
5. Continuous disclosure - Further amendments to the misleading and deceptive conduct provisions in section 1041H of the Act and section 12DA of the ASIC Act to make the changes consistent.

Virtual meetings

The Business Council strongly supports the notion that a company should be able to hold a meeting of members in whole or in part through the use of technology, provided that the format of the meeting gives members as a whole the same opportunity to participate in the meeting, and that accountability of the company is not diminished.

The Bill will enable companies to conduct 'virtual meetings' for a further six months until 15 September 2021. The Government will also conduct a 12-month opt-in pilot of hybrid Annual General Meetings.

These reforms recognise the current and future capacity for technology to facilitate the holding of company meetings in a more modern and efficient manner. They will also bring Australia into line with other comparable jurisdictions, such as the United Kingdom, Canada and parts of the United States.

The ability to hold 'virtual meetings' has been necessary as a result of limits on the size of physical gatherings since the onset of COVID-19. It is likely that such limits will continue to apply in some form for the foreseeable future. As such, it is not tenable for the law to revert to the pre-COVID position, which will occur once the existing temporary measures expire in March 2021. If the Bill is not passed by this time, many businesses will be put in the impossible position of being required to conduct meetings in person but not being able to physically do so according to the law as it stands under the Act.

Electronic execution of documents

The Bill will extend temporary measures allowing for electronic documents to 15 September 2021. The COVID-19 period has provided an opportunity to trial changes to electronic execution of documents as a result of the temporary measures implemented in 2020. The response of Business Council members to this trial has been overwhelmingly positive, with no substantive concerns expressed.

Allowing for the electronic execution of documents means that company officers need not be physically located in the same place as other parties, which removes unnecessary costs and delays on a range of transactions and decisions. It reflects the reality that, prior to COVID-19, many businesses were increasingly entering into transactions and contracts electronically, where it was possible to do so.

The Bill removes requirements for counterparties and their legal advisers to require proof of the technical and procedural matters that the Act would otherwise allow them to assume. Even in the absence of these measures as a result of COVID-19, such reforms to the Act were already desirable in order to keep pace with developments in technology that now enable businesses to execute documents without company officers or advisers being physically present.

The Government has indicated that it intends to finalise permanent arrangements for electronically signing and sending documents prior to 15 September 2021. This is a positive process that will enable the Government and all interested parties to have input into the permanent regime that will be implemented after this time.

Most notably, these reforms are another major step forward in the shift to a digital economy. Australia needs to adapt and keep pace with other jurisdictions if we are to more fully unlock the productivity benefits that will flow from the use of digital technology.

Recommended amendments to the Bill

The Business Council supports the changes in the suggested drafting of amendments to sections 127 and 129 of the Bill, which have been made since the Treasurer's Determination and the exposure draft Bill of October 2020. Nevertheless, there are two aspects of the drafting that could be improved. We recommend the following two amendments to enhance the workability of the measures.

'Copies' and 'counterparts' of documents

The Bill states that a 'copy or counterpart of a document' can be executed electronically but seems to assume there is still some separate original document. The copy or counterpart is an original, and there is no need for a separate original. In practice, each executed copy or counterpart is an original. This should be clarified to remove this confusion.

Second, the Bill requires copies and counterparts to include 'the entire contents of the document'. Documents can run to over 1000 pages. It is very common practice, particularly in larger transactions or with larger documents, for the documents to be signed are emailed to the signer, who does not print out the entire document, but only prints out only the signature pages, and signs those. The signer has a chance to read the entire document on screen before signing. Despite the Explanatory Memorandum, the language used in the section seems clearly to require the entire document to be printed.

Extend the provisions of the Bill to other types of corporations

Finally, the provisions of the Bill deal with companies. They do not extend to foreign and statutory corporations. Such corporations are very active in Australian commerce and should be able to sign documents (including deeds) in the same way. The measures in the Bill to facilitate electronic execution are an overdue modernising of the Act to enable Australian businesses to make use of technology to manage their affairs more efficiently. There is no good reason why certain types of businesses operating in Australia should be denied this opportunity.

Continuous disclosure obligations

The Business Council support a continuous disclosure regime that:

- Encourages business to invest, take risks and create jobs;
- Is consistent with strong disclosure practices and well-informed securities markets;
- Penalises blameworthy conduct but not inadvertent mistakes; and
- Ensures that there is an effective and fair means for smaller investors to be compensated for loss in appropriate circumstances (including a role for litigation funders).

The Bill will achieve these goals and address very clear problems with the current regime that require urgent resolution, as outlined below.

Temporary changes to the continuous disclosure regime under the Act were implemented in May 2020, in recognition that the highly uncertain economic climate created by COVID-19 meant it would be virtually impossible for many businesses to continue to be able to meet disclosure obligations under the existing strict liability regime.

Whilst the economic environment will continue to be uncertain, the experience since the implementation of the temporary measures has shown that a strict liability regime will be untenable moving forward, even if conditions return to a state of relative normality.

The replacement of a strict liability standard with a fault-based element will return the test to that which applied prior to amendments to the Act made in 2001, when strict liability was introduced. The reasons for the 2001 amendments were not explained at the time and the policy rationale for them remains unclear. Their shortcomings have become obvious in terms of their impact on:

- The cost of Directors and Officers insurance;
- The proliferation of speculative legal actions they have encouraged;
- No demonstrable improvement in the quality of disclosures; and
- The willingness of good quality candidates to sit on the boards of Australian public companies because of the risk of personal liability for failure to comply with the provisions, even where that failure was unintentional.

The reforms in the Bill will ensure a reasonable, clear and consistent standard applies in relation to corporate disclosures. They will continue to protect investors from wrongdoing but prevent private action where appropriate diligence has been applied, or under circumstances beyond the control of directors or companies. They will create a regulatory regime that is more conducive to investment and market disclosure.

Problems that will be resolved by this Bill

The need to remove strict liability on entities

Under the strict liability disclosure regime in section 674 of the Act, there is no defence for entities for breaches of continuous disclosure obligations. The Act imposes liability where there is no blameworthy conduct, even where it can be shown that reasonable care has been taken. This applies to any statement in any announcement to the ASX, including financial results and disclosures in connection with equity and debt raisings.

For individuals, a director may be liable under section 674 if they are 'involved' in a breach. As a person, they would have a defence if they took 'reasonable steps' and had 'reasonable grounds' to believe that the entity was complying with its obligations. There is no reason why such defences should be available to officers of companies but not the company.

Encouragement of speculative legal claims

The current regime has led to an excessive use of shareholder class actions that are pursued on an opportunistic basis. Such actions are not motivated by the objective of promoting a higher standard of disclosures, nor have they resulted in any such improvements. They are simply taking advantage of the opportunity presented by the existing unrealistic legal standard imposed on businesses under the strict liability regime.

Impact on disclosures and insurance

The result has been companies making fewer, and more cautious disclosures. There has been a clear change in approach over the last 10 years, where companies that previously provided forecasts for revenue, profit and dividends are less inclined to do so.

The result of opportunistic shareholder actions, and the culture they have created, is that the extra cost of such actions is ultimately factored into the cost of equity capital, with resulting detrimental effects to all shareholders. In addition, the cost of Directors and Officers insurance has increased to such unsustainable levels that it is now at risk of becoming prohibitive for smaller listed companies.

The cost of D&O insurance premiums rose on average by 118 per cent in 2019 with the most extreme rise at 600 per cent. The average rise for the first quarter of 2020 was 225 per cent.[1] This has also created heightened risks for directors and difficulties in attracting directors onto boards. Smaller ASX companies are hit particularly hard. Boards of companies outside the ASX 200 that are not household names need to actively reach out to investors. When looking for new directors, the issue of insurance is a real focus, as are the distractions associated with burgeoning litigation and reputational risk.

Impact on shareholders

Finally, the growth in shareholder actions has not delivered benefits to shareholders, taken as a whole. A significant proportion of the returns from litigation goes to litigation funders and plaintiff lawyers, including litigation that is settled between the parties before a court judgement. The Australian Law Reform Commission inquiry into class actions and litigation funders, which reported in early 2019, found that the median return to plaintiff group members in funded class action matters between 2013 and 2018 was only 51 per cent of the total damages awarded, after funding commissions and legal costs.[2]

Shareholders who bought shares in a market said to be adversely affected by the disclosure are, of course, suing their own company. Insurance (if available) will cover some of the costs of any losses, but all shareholders in the company bear the remaining costs. Most shareholders invest in a portfolio of companies and most investment in listed companies occurs through superannuation and other managed funds that hold large portfolios. Even if a small recovery is made by a shareholder on one portfolio holding (after the lawyers and litigation funders have been paid), that company will be out of pocket on the claim and it and all the other companies in the shareholder's portfolio are paying higher insurance premiums, which reduce dividends or capital growth. Taken as a whole, it is a negative sum game for shareholders.

Other reforms which would simplify class actions and reduce costs were canvassed in the report of the Parliamentary Joint Committee on Corporations and Financial Serves into *Litigation funding and the regulation of the class action industry* of December 2020. The Business Council recognises the potential for such reforms to deliver better outcomes for shareholders generally. We look forward to these matters being considered by Government in due course.

The current disclosure regime is an aberration

The strict liability regime under the Act is an aberration both in terms of previous Australian laws regulating disclosure and comparable laws in comparable foreign jurisdictions.

It should be noted that the temporary 2020 changes restored continuous disclosure rules to the position that applied prior to the *Financial Services Reform Act 2001*, and which had served financial markets and shareholders well. Before that time, it was a breach of the Act for an ASX-listed entity to 'intentionally', 'recklessly' or 'negligently' contravene the continuous disclosure rules.[3] This test imposed a fault element for continuous disclosure contraventions.

This fault element was removed in what was purportedly a 'housekeeping' change to the Act in 2001. That 'housekeeping' change was not mentioned at the time by the Joint Parliamentary Committee on Corporations and Securities, the Department of the Parliamentary Library, or by any of the Members who spoke during the Parliamentary debate on the Bill. Nor was it referred to in the Explanatory Memorandum to the Bill.[4] The

[1] Marsh Pty Ltd, Submission to Joint Parliamentary Committee on Corporations and Financial Services Inquiry into litigation funding and the regulation of the class action industry, No.3, June 2020 https://www.aph.gov.au/DocumentStore.ashx?id=cde3a5c9-dcd3-4ca1-91c4-0b2a879f10f5&subId=684478

[2] ALRC Report 134 *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* at paragraph [9.50], page 273 https://www.alrc.gov.au/wp-content/uploads/2019/08/alrc_report_134_webaccess_2.pdf.

[3] Former Corporations Act section 1001A(2). Note that under former section 1001A(3), the contravention was only an offence if the failure was intentional or reckless.

[4] ALRC Report 134 *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* at paragraph [9.17], page 262

supposed 'housekeeping' change has had unfortunate unintended consequences. Whether intentionally or not, it created the system of strict liability for continuous disclosure breaches under section 674(2) and a clear pathway for class action litigants to pursue ASX-listed entities in opportunistic claims.

Australia's strict liability regime is also out-of-step with comparable jurisdictions. US and UK laws relating to disclosure and misleading statements are not strict liability and require an element of blameworthy conduct.

In the United Kingdom, a claimant must prove 'knowledge' or 'recklessness' as to whether published material was untrue or misleading, or 'dishonest concealment' in relation to omissions. In the United States, a plaintiff needs to demonstrate that the defendant acted 'knowingly'. The reforms in the Bill will belatedly align Australia with these jurisdictions and restore the law to its pre-2001 state.

Recommended amendments to the Bill

Section 674A – clarify that the provision is only contravened where the contravention is intentional, reckless or negligent

Proposed section 674A in the Bill is drafted in the same terms as the temporary COVID-19 instrument. Liability is only triggered if an entity *"knows, or is reckless or negligent with respect to whether, the information would, if it were generally available, have a material effect on price or value."* [5]

This drafting has a number of issues. First, it is unclear how courts will approach the question of how an entity can show that it was not negligent with respect to whether particular information would have the requisite effect on the market if disclosed. Second, there may be breaches of the provision that are unintentional, and without recklessness or negligence, but which do not relate to the entity's assessment of the likely impact on price or value.

The uncertainty is created by the way in which the Bill ties the requirement for actual knowledge, recklessness or negligence to the effect of the information on the market. A better and clearer approach would be to adopt the drafting in the Act prior 2001, namely, that an entity is not in breach unless the breach itself is intentional, reckless or negligent. As mentioned above, there may be breaches of the provision that were unintentional and without recklessness or negligence, but which did not occur because of a mistaken belief about impact on the market but because of some other reason (eg. a mistaken belief about whether information is sufficiently certain to be able to be disclosed).

The recommended amendment also better reflects the intention of the Bill to ensure that, in determining whether a listed disclosing entity contravenes its existing continuous disclosure obligations, its state of mind is taken into account.

The recommended amendments to section 674A are set out below, with proposed changes to the text of the Bill marked up:

> ***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*

[5] Sub-section 674A(2)(d)

(c) the information is not generally available; and

(d) ~~the entity knows, or is reckless or negligent with respect to whether, the information would~~ 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: Except for the operation of subsection (2A)~~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)).

(2A) An entity does not contravene subsection (2) by failing to notify the market operator of that information in accordance with those provisions unless such failure was intentional, reckless or negligent.

(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**.*

(4) A person does not contravene subsection (2) or (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.

Section 674 – re-insert the due diligence defence, but for the benefit of the entity itself

As drafted, the Bill retains the existing section 674 as an offence for breaches of continuous disclosure obligations. Whilst the new civil penalty regime in section 674A will only be breached where the contravention involves knowledge, recklessness or negligence, an entity is still guilty of an offence under section 674 where those elements are not present. It thus retains a strict liability test without a defence.

If section 674 is to be retained, the due diligence defence in section 674(2B), which will be omitted by the Bill, needs to be re-inserted into section 674 for the benefit of the entity itself. This would ensure that the 'reasonable enquiries' defence, which is available for accessorial liability of officers under proposed section 674A, is also available to the entity under section 674.

To achieve this outcome, we recommend amending section 674 by inserted the following as sub-section 647(2A):

(2) A listed entity does not contravene subsection (1) if that entity proves that it:

(a) took all steps (if any) that were reasonable in the circumstances to ensure that it complied with its obligations under subsection (1); and

(b) after doing so, believed on reasonable grounds that it was complying with its obligations under that subsection.

Misleading conduct – Section 1041H of the Act and section 12DA of the ASIC Act – further amend the provisions to make the changes consistent where the entity gives a continuous disclosure notice

The Bill includes changes to section 1041H of the Act and section 12DA of the ASIC Act to ensure that entities and officers are not liable for misleading and deceptive conduct in circumstances where the continuous disclosure obligations have been contravened, unless the requisite mental element in the continuous disclosure obligation has been proven. These provisions also need to be modified to ensure that entities and officers are not liable for misleading and deceptive conduct if they have in fact given a continuous disclosure notice, unless the requisite mental element has been proven.

To achieve this outcome, we recommend the addition of a new sub-section 1041H(3)(d), as follows:

> ***(d) If a person engages in conduct in relation to a continuous disclosure notice, which conduct is not intentional, reckless or negligent, the person's engaging in that conduct does not contravene subsection (1).***

The *Australian Securities and Investment Commission Act 2001* (ASIC Act) also includes similar provisions related to misleading and deceptive conduct in section 12DA, which are also the subject of consequential amendments made by the Bill. For the same reasons as outlined above, these provisions of the ASIC Act should also be amended in the same terms, through the addition of a new sub-section 12DA(1A)(d) as follows:

> ***(d) If a person engages in conduct in relation to a continuous disclosure notice, which conduct is not intentional, reckless or negligent, the person's engaging in that conduct does not contravene subsection (1).***

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