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Submission – Inquiry into Treasury Laws Amendment (2021 Measures No 1) Bill 2021

Introduction

We appreciate this opportunity to make a submission to the Senate Economics References Committee on the Treasury Laws Amendment (2021 Measures No 1) Bill 2021 (the ***Bill***).

For some time, Allens has advocated for reform to the continuous disclosure regime and the private rights of action raising from a possible breach. Most recently, in June 2020, we made a submission to the Parliamentary Joint Committee on Corporations and Financial Services in respect of its inquiry into litigation funding and the regulation of the class action industry (the ***Inquiry***).[1]

In our submission to the Inquiry, we welcomed the measures taken by the Australian Government in May 2020 temporarily amending the continuous disclosure rules under the *Corporations Act 2001* (Cth) (***Corporations Act***). At the same time, we encouraged the implementation of more comprehensive and permanent reform to the continuous disclosure regime and associated private rights of action.

Reforms of this nature are critically important to addressing the current imbalance in Australia's shareholder class action regime. Shareholder class actions have a significant (and draining) effect on listed entities, their shareholders (including the impact on the value of the investments of group members themselves) and their insurers.

We therefore welcome the amendments proposed under the Bill, including:

- the permanent restoration of the fault elements of intent (knowledge), recklessness and negligence that were present at the time the continuous disclosure regime came into operation;[2] and
- consequential amendments to s 1041H of the Corporations Act and s 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (***ASIC Act***) dealing with misleading or deceptive conduct, to introduce the same mental elements where misleading or deceptive conduct claims are brought on the basis of the same conduct as continuous disclosure breaches.

Our submission will address some potential practical limitations arising from the drafting of the current proposed Bill, as follows:

1. it is not immediately clear how the proposed amendment to s 1041H of the Corporations Act and s 12DA of the ASIC Act will apply if a misleading or deceptive conduct claim is not accompanied by an alleged breach of the continuous disclosure provisions. The amendments may have the potential unintentionally to reverse the onus of proof so that an entity is left seeking to establish that its conduct the subject of the misleading or deceptive conduct claim would also have been a contravention of the continuous disclosure provisions but for the mental element not being satisfied, so that the mental element is then applicable to the misleading or deceptive conduct claim;
2. as noted in our submission to the Inquiry,[3] the inclusion of a negligence standard alongside the subjective fault elements of knowledge and recklessness, which imports a 'reasonable person' test similar to the standard under the current (unmodified) regime, may reduce the practical impact of the reforms. It is important that the legislative intention behind how the new fault element is to apply is stated clearly so that its intended impact is achieved; and

[1] Allens Submission, 'Inquiry into Litigation Funding and the Regulation of the Class Action Industry': https://www.aph.gov.au/DocumentStore.ashx?id=dabb7ffc-d440-478b-aaf9-f37b72c5df99&subId=684848
[2] Ibid at 7 [18].
[3] Ibid at 8 [19(b)].

3. as noted in our submission to the Inquiry,[4] the amendments proposed only address circumstances in which there is an alleged breach of the continuous disclosure regime in connection with a company's or director's assessment of whether particular information is price sensitive. The reforms do not provide any relief for any other form of innocent breach of the continuous disclosure regime.

These points are addressed in turn below.

1 Interaction between continuous disclosure and misleading or deceptive conduct reforms

Under s 1041H(1) of the Corporations Act, a person must not engage in conduct in relation to a financial product or service that is misleading or deceptive or that is likely to mislead or deceive. Section 12DA(1) of the ASIC Act is a similar provision.

The Bill adds a 'carve out' at sub-s (4) of the Corporations Act (and sub-s (3) of the ASIC Act) intended to harmonise the continuous disclosure and misleading or deceptive conduct regimes. Taking s 1041H(4) of the Corporations Act as an example, a disclosing entity will not engage in misleading or deceptive conduct in contravention of s 1041H(1) by engaging in conduct that does not contravene the continuous disclosure civil penalty provisions, but would contravene those provisions if the fault element did not exist. The carve out in the ASIC Act works similarly.

This means that, if a disclosing entity engages in conduct that contravenes the continuous disclosure provisions under s 674 but that conduct does not result in a contravention under the new civil penalty provision in s 674A because none of the fault elements of knowledge, recklessness or negligence is satisfied, then the entity has correspondingly not contravened the misleading or deceptive conduct regime by virtue of that same conduct.

The Explanatory Memorandum anticipates the effect of this 'carve out' to be that if a person seeks a remedy against a disclosing entity under the Corporations Act for alleged misleading or deceptive conduct and that contravention is 'connected to' an alleged failure to comply with the continuous disclosure provisions, then the person seeking the remedy (whether a regulator or a party to a civil suit) cannot succeed in either the continuous disclosure or misleading or deceptive conduct claim unless they can establish the fault element of knowledge, recklessness or negligence.

However, the drafters appear to have anticipated only circumstances in which continuous disclosure claims are brought alongside misleading or deceptive conduct claims.[5] This leaves open the possibility that where an entity engages in conduct that would have been a breach of both the continuous disclosure provisions and the misleading or deceptive conduct provisions but for the fault element not being satisfied, a claimant could strategically choose not to pursue the continuous disclosure breach; thereby avoiding the application of the carve out which would introduce the fault element into the misleading or deceptive conduct claim.

Take the following case study, for example:

(a) Company A fails to disclose information to the market which was price sensitive, in breach of s 674. Company A reasonably and in good faith formed the view that the information was not price sensitive, but that view was ultimately found to have been wrong. The fault element for a continuous disclosure breach under s 674A is not satisfied.

[4] Ibid at 8 [19].
[5] The Supplementary to the Explanatory Memorandum cites each of *TPT Patrol Pty Ltd v Myer Holdings Ltd* [2019] FCA 1747 and *Crowley v Worley Ltd* [2020] FCA 1522 to the effect that continuous disclosure and misleading or deceptive conduct claims are frequently brought together, noting that 'it is clear that changing the standard' for both of these actions 'will achieve the policy intent of amending the continuous disclosure provisions' as recommended by the Inquiry.

(b) Claimant commences civil litigation against Company A claiming misleading or deceptive conduct under the Corporations Act and the ASIC Act. Claimant does not make any allegation against Company A in respect of the continuous disclosure provisions.

(c) Because there is no allegation against Company A that it breached the continuous disclosure provisions, it is not clear whether the carve out to the ASIC Act and Corporations Act misleading or deceptive conduct provisions applies. That is, it is not clear whether Claimant must establish the fault element under the continuous disclosure provisions in order to succeed on the misleading or deceptive conduct claim.

In this case study, Company A may be left in a situation in which the only way to attract the operation of the carve out (being the application of the fault element) to the misleading or deceptive conduct allegations is for it to assert that its conduct the subject of those allegations was also a contravention of the continuous disclosure obligations in s 674 of the Corporations Act, but was not a contravention of the civil penalty provision in s 674A because the fault element was not established.

This essentially may have the unintended effect of reversing the onus of proof in such circumstances so that an entity is left arguing that its own conduct was a breach of law in order to attract the operation of the misleading or deceptive conduct carve out.

In our view, this is likely an unintended consequence of the drafting of the Bill, which should be addressed.

2 Negligence and the 'reasonable person' standard

The current (i.e. unmodified) continuous disclosure provisions concern information that is not generally available and that a 'reasonable person' would expect to have a material effect on the price or value of ED securities of that entity.[6] The test is an objective one.[7]

'Reasonable person' is not defined by the Corporations Act.[8] The ASX Listing Rules: Guidance Note 8 (Continuous Disclosure) (the ***Guidance Note***) states that (in the context of ASX Listing Rules 3.1 and 3.1A)):

> the reasonable person test is an objective one. It is to be judged from the perspective of an independent and judicious bystander and not from the perspective of someone whose interests are aligned with the entity or with the investment community.[9]

The Guidance Note observes that Listing Rule 3.1A.3 uses the term 'reasonable person' rather than 'reasonable entity' or 'reasonable investor'.[10] It cites *Jubilee Mines NL v Riley*, in which McLure JA noted that the 'hypothetical reasonable person in [the predecessor to Listing Rule 3.1A.3] … is an objective outsider'.[11] His Honour distinguished such a person from an expert in the field.

The Guidance Note states that the reasonable test has 'a very narrow field of operation'.[12] Specific examples of information that the ASX considers a reasonable person would not expect to be disclosed are provided, including confidential information that an entity is planning to make a unilateral takeover bid for another entity (disclosure of which could jeopardise the transaction)

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[6] See, e.g., s 674(2) of the Corporations Act.
[7] *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; *James Hardie Industries NV v Australian Securities and Investments Commission* [2010] NSWCA 332.
[8] However, s 677 provides that a reasonable person would be taken to expect information to have a material effect on the price or value of ED securities of a disclosing entity if the information would, or would be l kely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the ED securities'.
[9] Guidance Note at 40.
[10] Ibid.
[11] [2009] WASCA 62 at 160.
[12] Guidance Note at 40.

and confidential legal advice (which could breach legal professional privilege and prejudice the entity and any of its investors).

Under the amendments proposed by the Bill, a negligence standard is included alongside the subjective fault elements of knowledge and recklessness. The test for negligence involves consideration by a court of whether a reasonable person in the defendant's position would have foreseen that his or her conduct might pose a risk of injury to the plaintiff and, if so, what the reasonable person would have done by way of response to this risk.[13] This 'reasonable person' has been described as 'the man on the Clapham omnibus'[14] or a 'reasonable man of ordinary intelligence and prudence'.[15] While the same standard of care is generally applied to all defendants, where a defendant has special knowledge or skill over and above that which would be ordinarily be expected of the reasonable person, he or she must live up to the higher standard of a reasonable person with that special knowledge or skill at the relevant time.[16]

The two tests should be applied differently. If the negligence standard does not import a higher standard than the current reasonable person test, there would be no purpose to the amendments proposed by the Bill. The current test asks whether a reasonable person would have considered the information to be price sensitive. The new test asks whether, in its assessment of the information as not being price sensitive, the entity fell short of the standard expected of a reasonable person in the entity's position.

For the reforms to achieve their intended effect, it is important that the legislative intention behind how the fault element of negligence is to apply (and how it is intended to be different to the current 'reasonable person' standard) is clearly expressed. If the fault element of negligence is viewed as importing the same (or a very similar) standard to the 'reasonable person' test currently applied under the unmodified regime, then the reforms will be limited in their practical impact and may not achieve their intended objective.

3 Limitation of reforms to issues of price sensitivity

As raised in our submission to the Inquiry, under the current unmodified continuous disclosure regime, civil liability arises where an entity fails to disclose non-public information and a reasonable person would expect that information, if disclosed, to have a material effect on share price or value. Under the amendments proposed by the Bill, civil liability arises where an entity fails to disclose non-public information and the entity knows, or is reckless or negligent as to whether, that information would, if disclosed, have that price impact.

The amendments do not assist a listed entity where a failure to comply with the continuous disclosure requirements is not due to a mistake about the price sensitivity of the information but because of some other fact. For example, where a company (honestly, but incorrectly) takes the view that the information is too uncertain to warrant disclosure, or where the information is known to one officer but not others. In other words, the amendments only provide protection from a breach of the continuous disclosure regime where the failure to disclose was due to an innocent (and non-negligent) mistake about price impact and does not provide protection for any other form of innocent breach. This limits the impact of the reforms to only one aspect of an entity's decision making about its public disclosures.

[13] See generally *Council of the Shire of Wyong v Shirt* (1980) 146 CLR 40 at 47-48 (Mason J).
[14] *McGuire v Western Morning News Co Ltd* [1903] 2 KB 100 at 109. See also *Papatonakis v Australian Telecommunications Commission* (1985) 156 CLR 7 at 36.
[15] *Glasgow Corporation v Muir* [1943] AC 448 at 457.
[16] *Rogers v Whitaker* (1992) 175 CLR 479. See also *Lloyd v Citicorp Australia Ltd* (1986) 11 NSWLR 286.

We welcome the opportunity to engage further on these important reforms.

Yours sincerely

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