CHAPTER 5

REPORTING OF PROCEEDINGS

Companies should be obliged to report any proceedings instituted against the company for any material breach by the company of the Corporations Law, or trade practices law, and, if so, a summary of the alleged breach and of the company's position in relation to it.

5.1 Four matters were referred to the PJSC that were the subject of complaint and/or concern expressed to the Government by the business community. The first of these is the proposal that companies should be obliged to report any proceedings instituted against the company for any material breach by the company of the Corporations Law, or trade practices law, and, if so, a summary of the alleged breach and of the company's position in relation to it.

5.2 The submissions which addressed this matter generally opposed the proposal. The evidence presented to the PJSC is set out below.

Arguments in favour of the proposal

Transparency

5.3 It was submitted that the guiding principle in reviewing the requirements of the Corporations Law must be that "maximum transparency must exist in the behaviour and operation of the company." In line with this argument, it was recommended that any amendment to the Law should be drafted so that the requirement for disclosure is equally important at each stage of the proceedings when the case is initiated, during its progress and after its finalisation.[1]

5.4 The Australian Law Reform Commission was of the view that disclosure of this kind is critical for investor confidence:

> Investors in, traders with and consumers of the goods/services of a company should be apprised of <u>all</u> proceedings against the company for significant alleged breaches of law, not simply those limited to the Corporations Law and the Trade Practices Act. All such matters relate to good corporate citizenship. They are, therefore, of real significance to persons investing in and dealing with the company. In particular, shareholders should be fully aware of these matters, so as

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1 Mr R Furlonger, Submission 4, p 5.

> to be able to hold management fully to account for them and be able to take them into account in their investment decisions.[2]

Corporate governance

5.5 Corporate Governance International Pty Ltd submitted that Corporations Law and trade practice law proceedings are areas of significant financial risk for listed companies'. Breaches of the legislation can reflect on the quality of governance in the company and on public confidence on the board or directors.[3]

5.6 Boral Ltd had no objection to extending the corporate governance matters required to be in a listed company's Annual Report to include a report on material breaches of the Corporations Law and Trade Practices Act.[4] Boral stated that "Arguably, prudent reporting already requires these matters to be covered in the corporate governance statement."[5]

Focus on compliance

5.7 The Australian Competition & Consumer Commission (ACCC) supported the proposal on the basis that it will increase the pressure on companies to comply with the Corporations Law and the Trade Practices Act. According to the ACCC, the disclosure requirement will focus the minds of company executives on the need for compliance at the outset. A further benefit is that it will provide additional information for shareholders/investors to make informed decisions. The ACCC noted that the requirement is to report only where proceedings have been instituted and where these relate to a material breach of the Law.[6]

Protection of shareholders' interests

5.8 Mr JA Sutton provided the PJSC with a case study to demonstrate the need for this requirement in the Law: A successful public company with a market capitalisation of $200 million became insolvent. The administrators of the failed company uncovered evidence of false reporting and insolvent trading and subsequently took legal action involving the directors, officers and auditors. After a series of actions, litigation ended with a confidential

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2 Australian Law Reform Commission, Submission 10, pp 3-4.

3 Corporate Governance International Pty Ltd, Submission 62, p 3.

4 Boral Ltd, Submission 14, p 1.

5 Boral Ltd, Submission 14, p 1.

6 Australian Competition & Consumer Commission, Submission 19, p 1. The ACCC commented that the reference to a material breach provided a safeguard against the reporting of vexatious and frivolous allegations.

settlement. Despite the prima facie evidence of fraud and false reporting, no further action was taken. Shareholders had little knowledge of the alleged misconduct and the possible denial of rights. The lack of information about the proceedings prevented members from questioning the board in a general meeting and from taking any appropriate action.

5.9 Mr Sutton submitted that for shareholders to be properly protected by a disclosure requirement of this kind, the reporting must be included in reports to shareholders. Further, that reporting must still apply where the processes of External Administration are in place and it should apply to proceedings against directors, officers and auditors of the company as well as those against the company.[7]

Best practice

5.10 The Accounting Bodies also supported the requirement in the interests of harmonising disclosures across jurisdictions. The PJSC was told that in the US, the Securities and Exchange Commission requires registrants to report the details of material legal proceedings to which the company, its subsidiaries, property or directors are a party.[8] The Accounting Bodies stated that it would be appropriate as a matter of "best practice" if Australian companies were to make similar disclosures.

5.11 Other matters raised by submissions as being appropriate for disclosure under this requirement are:

- The material details of both actual and threatened cases against listed companies;
- A statement as to whether the particular action is an isolated or test case;
- Details of legal expenses, if material;[9]

Arguments against the proposal

Special status not justified

5.12 It was argued by Mr Reg Barrett that this requirement accorded a special status to the Corporations Law and the Trade Practices Act:

> The first question here is why two pieces of legislation mentioned merit this special focus to the exclusion of all others. Why are

7 Mr JA Sutton, Submission 57, p 3.

8 Joint Submission by the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, Submission 73, p 6.

9 Mr Nick Renton, Submission 58, p 2.

> company law, competition law and consumer protection matters particularly deserving of such compulsory treatment? Why not include occupational health and safety laws, superannuation laws, taxation laws and workplace relations laws? If the aim is to bring to public knowledge instances where a company is alleged to have fallen short of some statutory standard, it should make no difference which statute is involved.[10]

5.13 A similar view was put by Ms Jan Wade MP, the Victorian Minister for Fair Trading, who stated that there was no policy rationale for choosing trade practice compliance over other kinds of compliance.[11] The Chartered Institute of Company Secretaries stated that there was no justification for highlighting these two specific areas of legislation.[12]

Appropriateness of including the requirement in the Corporations Law

5.14 It was also argued that the Corporations Law is not the appropriate medium for introducing this requirement if the real aim of disclosure is to bring out information about good corporate citizenship.[13] Mr Barrett stated that 'reporting' in the context of the Corporations Law is directed primarily at matters having a financial impact and, under the present law, material breaches of legislation already play a part in the preparation of the financial accounts and their examination by auditors. Where there is the likelihood of an adverse financial impact arising from litigation, notes to the accounts will draw attention to this. Mr Barrett stated that "material breaches of legislation (with materiality judged in the financial sense) already play a part in the formulation of financial material placed by companies before their members."[14] As such, a requirement for companies to disclose proceedings instituted against them does not serve a financial information purpose.[15]

Provision for contingent liabilities

5.15 The Accounting Association of Australia and New Zealand (AAANZ) advised that current accounting standards already provide for the disclosure of provisions and liabilities on contingent items in annual reports.[16] Associate Professor Phil Hancock, Member, Legislation Committee of the AAANZ,

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10 Mr RI Barrett, Submission 5, p 4.

11 Ms Jan Wade MP, Submission 74, p i.

12 Chartered Institute of Company Secretaries in Australia Ltd, Victoria Branch, Submission 24, p 2.

13 Mr RI Barrett, Submission 5, p 5.

14 Mr RI Barrett, Submsision 5, p 5.

15 Mr RI Barrett, Submission 5, p 5.

16 See Accounting Standard AASB 1034 "Information to be Disclosed in Financial Reports".

further noted that the accounting bodies are moving to adopt a new international standard on provisions and contingent items that will broaden the coverage of contingent events. He indicated that the IASC standard would soon be adopted in Australia.[17]

The institution of proceedings is not proof that a breach has occurred

5.16 The PJSC was reminded that there is "a world of difference" between the commencement of proceedings and the proving of an allegation of a breach of law or that an offence has been committed. Mr Barrett illustrated this point with reference to proceedings under the Trade Practices Act:

> It is commonplace for alleged breach of section 52 of the Trade Practices Act to be worked into what are in essence ordinary breach of contract claims. Thus, a computer supplier whose customer finds fault with the product supplied will sue for damages not only for breach of contract but also on the basis that some misleading or deceptive statement was made or conduct occurred in the course of the sale transaction. This is part and parcel of commercial life. But the allegation is no more than just that.[18]

5.17 Other submissions objected to the proposed disclosure requirement on the ground that the institution of proceedings in itself is not proof that a breach has been committed and reporting on such matters may only serve to give credibility to what might otherwise be vexatious or frivolous claims. Where allegations are made public, the perception can be that the allegations are true, which would be misleading.[19] It was also suggested that proceedings against a company might be commenced for purely tactical or collateral purposes.[20]

Disclosure might prejudice a company's defence and offers no protection against self incrimination

5.18 A principal objection to the disclosure of proceedings instituted against companies and a summary of any alleged breach of particular legislation is that these types of disclosures might operate to prejudice a company's defence and therefore harm shareholders' interests.[21] Caltex Australia Ltd opposed the requirement on the grounds that it would be clearly prejudicial to the

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17 Associate Professor Phil Hancock, Committee Hansard, 16 August 1999, p 155. International Standard IASC No 37.

18 Mr RI Barrett, Submission 5, p 5.

19 Henry Walker Group Ltd, Submission 12, p 3; Coles Myer Ltd, Submission 87, pp 4-5; Australian Listed Companies Association Inc, Submission 66, p 2.

20 Arnold Bloch Leibler, Submission 23, p 6.

21 Henry Walker Group Ltd, Submission 12, p 3; Chartered Institute of Company Secretaries in Australia Ltd, Victoria Branch, Submission 24, p 2; Ernst & Young, Submission 38, p 2.

company's position and would serve no public purpose. Such an obligation could give rise to a waiver of privilege in relation to legal advice and provided no protection against self-incrimination. Caltex Australia submitted that denial of the privilege against self-incrimination to a corporation would undermine its position in the adversary system of justice.[22]

5.19 Viewed in the context of the continuous disclosure regime, Freehill Hollingdale and Page advised the PJSC that additional reporting obligations are undesirable and would place companies in an invidious position:

> They could force companies into making written admissions, which could then be used against the company in litigation. This would usually not be in the interests of shareholders.
>
> Again, there is a substantial risk of disproportion between reporting and impact upon the company.[23]

Cost of compliance – a case study: Coles Myer Ltd

5.20 At its hearing, the PJSC was told that Coles Myer Ltd received a large but decreasing number of claims and allegations against it because of the nature of its business activities.[24] Coles Myer questioned the cost benefit that would flow from requiring a company to list in its annual report the allegations of material breaches of the relevant legislation. The PJSC requested Coles Myer Ltd to provided an estimate of the potential cost of complying with the proposed requirement.

5.21 In response Coles Myer indicated that 138 documents were formally served on the company in the last 12 months that related to legal proceedings. Coles Myer advised that it received 11 in September 1998, 15 in October 1998, 13 in November 1998, 7 in December 1998, 17 in January 1999, 13 in February 1999, 13 in March 1999, 11 in April 1999, 11 in May 1999, 15 in June 1999, 7 in July 1999 and 5 in August 1999.

5.22 Based on the total number of documents served on the company, Coles Myer estimated the following additional annual costs that it would incur in reporting alleged material breaches:

> To collect the information and have external legal advice as to which allegations are related to alleged material breaches ($150,000).
>
> The cost of internal lawyers to review each allegation ($69,000, $500 per claim on a conservative basis).

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22 Caltex Australia Ltd, Submission 30, pp 2-3.

23 Freehill Hollingdale and Page, Submission 40, p 3.

24 Mr Tim Hammon, Committee Hansard, 17 August 1999, p 271.

> To have external lawyers handling each matter settle the wording so that the company does not prejudice its position in regard to each allegation ($100,000).
>
> To ensure that the reporting of the allegations are not defamatory to the parties involved with each claim ($50,000).
>
> Dealing with the disclosure in litigation and in the courtroom ($100,000).
>
> Dealing with the non-disclosure in litigation and in the courtroom ($100,000).
>
> Costs of directors being called to be examined in litigation on the information that they have, or have not, included in their directors report ($100,000).
>
> Briefing directors as witnesses and attendance on counsel ($100,000).
>
> To settle the note relating to reporting compliance ($5,000).
>
> **Costs estimated to be in excess of $750,000.**

5.23 Coles Myer was unable to put a total cost on complying with the requirement if this resulted in subsequent defamation action.[25]

Adequacy of existing disclosure requirements

5.24 Several organisations and individuals were of the view that the existing requirements for disclosure in annual reports or under the provisions of the ASX's continuous disclosure are adequate.[26] The Association of Mining and Exploration Companies Inc (AMEC) argued that:

> As highlighted previously, Listing Rule 3.1 requires companies to disclose continuously material events. AMEC contends that Listing Rule 3.1 is a sufficient and effective method of company disclosure which negates the need for the provision detailed above.[27]

5.25 Similarly the Investment & Financial Services Association Ltd did not believe that "it is necessary to enact these types of provisions as the existence

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25 Correspondence to the PJSC, 1 September 1999, pp 4-5.

26 Accounting Association of Australia and New Zealand, Submission 16, p 1. See also Suncorp-Metway Ltd, Submission 17, p 2; Chartered Institute of Company Secretaries in Australia Ltd, Victoria Branch, Submission 24, p 2; Mr Peter Jooste QC, Submission 48, p 1; Association of Mining and Exploration Companies Inc, Submission 45, p 2; KPMG, Submission 71, p 3; Securities Institute, Submission 75, p 1; Australian Institute of Company Directors, Submission 47, p 3; Belmont Holdings Ltd, Submission 20, p 2.

27 Association of Mining and Exploration Companies Inc, Submission 45, p 2.

of proceedings will be publicised and directors are already obliged to disclose contingent liabilities under the continuous disclosure regime."[28]

5.26 Likewise, the PJSC was told that the suggested additional requirement would "add no further value to the manner in which these issues are presently dealt in terms of the current Corporations Law requirements."[29]

5.27 Caltex Australia contended that the existing reporting requirements are sufficient:

> … auditors have for some time been obliged to report suspected contraventions of the Corporations Law by companies they audit to the Australian Securities and Investment Commission (ASIC). That obligation is now contained in section 311 of the Corporations Law. This process ensures that contraventions are brought to the attention of the ASIC at the earliest possible opportunity, and addressed by the regulator.[30]

Control of legal proceedings

5.28 A possible consequence of placing information about legal proceedings in the public arena is that the proper control and process of those proceedings might be jeopardised. A basic principle of the judicial system is that the court controls proceedings rather than the media, the ASIC or any other authority. It was argued that the illogicality of the proposal is demonstrated by extending the disclosure requirement to all individuals, corporate bodies and individuals against whom any proceedings are instituted for any breach of any law. It would be unacceptable to require those defendants to provide a summary of the alleged breach and the defendant's position in relation to it. Mr John Wilkin, General Counsel, Corrs Chambers Westgarth, told the PJSC that:

> It is submitted that it is fundamental to the administration of justice and the fairness of process that companies against whom breaches are alleged should not have to confess or plead in public, or state their position, or take or omit any step other than those required by the law for those proceedings. It is for the court to control those proceedings, not the media, the ASC or anyone else.[31]

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28 Investment & Financial Services Association Ltd, Submission 34, p 4.

29 Permanent Trustee Company Ltd, Submission 46, p 2.

30 Caltex Australia Ltd, Submission 30, p 3.

31 Mr John Wilkin, Submission 21, p 3.

5.29 Mr Wilkin emphasised that it was a matter for the courts to assess what the company's position is in relation to the alleged offences, when it must plead and whether the case will be brought to trial.[32]

Negative impacts beyond share price

5.30 Arnold Bloch Leibler opposed the disclosure requirement on the grounds that the disclosure of proceedings might have a continuing damaging effect on the company beyond its share price. Under the continuous disclosure regime companies are required to disclose in the directors' report any proceedings against the company that might affect the company in a 'material' way. According to Mr John Fast, a partner with the law firm Arnold Bloch Leibler, the additional reporting, which is based on whether proceedings have been instituted, might have a continuing damaging effect on investor confidence, on the company's share price, its credit rating, and banking arrangements, even after the matter has been resolved.[33] Mr Fast questioned whether the disclosure would enhance shareholder knowledge:

> The problem is that being required to report it does not mean that it adds anything factually to the state of knowledge of shareholders. I do not think one ought to encourage a regime where shareholders may make decisions based purely on the question of whether proceedings have been instituted as opposed to whether they have been resolved and whether or not a company has or has not finally got a matter for which they are liable.[34]

When to report proceedings?

5.31 Several submissions drew attention to the changing nature of litigation and whether disclosures can be meaningful where, at an early stage of proceedings, a company may have only one defence, to deny the allegations because that is the only defence it can make at that stage of the proceedings. Mr Paul Evans, a partner with Freehill Hollingdale & Page, advised the PJSC that "the nature of the types of allegations that are made, particularly in the trade practices context, are such that it is almost impossible to state a position at an early stage in the proceedings which is meaningful, other than to simply deny."[35] As an overriding point, statement of claims might be struck out or amended and in this situation a company would be required to summarise each new allegation:

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32 Mr John Wilkin, Committeee Hansard, 16 June 1999, p 42.

33 Arnold Bloch Leibler, Submission 23, p 6.

34 Mr John Fast, Committee Hansard, 16 June 1999, p 60.

35 Mr Paul Evans, Committee Hansard, 16 August 1999, p 140.

> **Ms JULIE BISHOP**-My other question related to your comment about companies having to report proceedings against them for breaches of Corporations Law or trade practices law and 'a summary of the allegations'. This additional reporting requirement beyond what we currently have, and where directors' reports or annual reports contain details of foreshadowed or current court cases, could lead to situations-and I presume this is what you are suggesting when you say that it is absurd-where allegations, however ill-founded or vexatious or even bizarre-and I have seen them all, as no doubt you have, in statements of claims against companies-would have to be disclosed. Yet as we know, statements of claim can be ever changing feasts of allegations and, from time to time, allegations are struck out or the statements of claim change in their entirety. Is that then one of the problems you see with this additional reporting requirement?
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> **Mr Wilkin-**I think the reporting requirement says that the company has to state its attitude-
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> **Ms JULIE BISHOP-**To each allegation.
>
> **Mr Wilkin-**To each allegation. In other words, it has got to put in a defence, a public defence or something like that, which I would regard as absurd. It seems to me contrary to the due administration of justice to require somebody to put their legal defence on the public record.
>
> **Ms JULIE BISHOP**-Obviously once an allegation has been aired-and it may well have been subsequently struck out by a court-it could have an ongoing impact on share price, investor confidence and the like?
>
> **Mr Wilkin-**It could have an effect upon the proceedings against it, surely. If it made a breach of trade practices law, then it can have proceedings against it. Depending on where it is, it might have class actions, that type of thing, against it; and its report would be discoverable, I suppose.[36]

Qualified privilege to attach to disclosure

5.32 An issue not raised in the written submissions but discussed at the PJSC's public hearing related to the status of the summary of the alleged breaches. In disclosing proceedings against it, a company must summarise the alleged breaches or offences. A statement of claim may contain defamatory material and a company's summary of the claim, without the protection of qualified privilege, has an uncertain status. Proceedings under the Trade Practices Act demonstrate this point:

> **ACTING CHAIR**-In relation to the second aspect, the requirement to summarise allegations and the company's position under

36 Mr John Wilkin, Committee Hansard, 16 June 1999, p 45.

> Corporations Law or trade practices, have you considered what would be the status at law of the company's response? Currently, if there is a statement of claim in, say, a trade practices proceedings, it can contain all sorts of allegations in relation to what might constitute misleading and deceptive conduct. There could be all sorts of defamatory imputations arising. I assume that under this the company would be obliged to set them out, or at least the substantial aspect of it, and then its response which might also reflect upon the plaintiff applicant. Have you considered the status in terms of defamation of what would be covered by privilege?
>
> **Mr Evans**-There would have to be an argument that if a disclosure of that nature is required by law it would be covered by qualified privilege. That, however, is by no means clear. One would certainly want to ensure that that privilege attached. To take an example, your standard statement of claim published by the commission against a trade practices contravener these days will generally join in the officers involved in the contravention who are directly personally liable. The company publishes the report that the company and X, its chief marketing officer, have been prosecuted for a contravention of section 45 or 45A relating to price fixing. That is one impact. It has a direct and immediate impact upon the individuals concerned where blame may ultimately not be established.[37]

Unclear drafting

5.33 Several submissions drew attention to the drafting of the proposal and, in particular, the term "material" breach. The PJSC was told the requirements relating to "material" breach are very broad and compliance may be difficult.[38] For example, a breach of the Trade Practices Act may be minor, but the financial penalty and the adverse publicity may be disproportionate to the breach.[39]

Restrictions on reporting

5.34 The PJSC was told that any requirement for the disclosure of such information should:

- Exclude "in-camera" proceedings;
- Be drafted in such a manner so as to prevent it being unfairly manipulated by persons wanting to impose an unfair burden on a company;

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37 Mr Paul Evans, Committee Hansard, 16 August 1999, p 140.

38 Ernst & Young, Submission 38, p 2.

39 KPMG, Submission 71, p 3.

- Exempt companies from compliance where disclosure would constitute a contempt of court or harm its defence;
- Permit a company to apply for relief from compliance;
- Be restricted to proceedings brought by a governmental agency;[40]
- Be made only once a court has found against the company.[41]

Conclusions

5.35 In general, the evidence before the PJSC was not supportive of the proposal. In the light of the continuous disclosure regime, it is difficult to assess the benefits arising from disclosures of this type particularly if a company's defence is a denial of the statement of claims or the alleged breach has not been proven. The institution of proceedings is not by itself proof that a breach has occurred or that an offence has been committed. If the proceedings have only been initiated, then it is premature for a company to declare its position in relation to the alleged breaches. Further, the nature of proceedings under the Trades Practices Act is such that the reporting of allegations or claims of breaches under section 52 can be misleading. As one witness told the PJSC, an allegation in these proceedings "is no more than just that."

5.36 The PJSC considers that legal proceedings should not be the subject of company reporting beyond the usual continuous disclosure requirements for reporting entities. When proceedings have commenced any written statements or admissions could be used against the company in litigation to the detriment of the company and its shareholders. Moreover, there is the difficulty in determining whether qualified privilege should attach to the company's summary of the statement of claim, especially where these contain defamatory imputations. The PJSC is also concerned about the high cost of compliance. This was estimated at over $750,000 annually for a large listed company. In the view of the PJSC the requirement is misplaced and should not be legislated. However, as a matter of corporate governance, companies should disclose the instituting of proceedings or make a fuller report when these have been concluded.

Recommendation

5.37 The PJSC recommends that the Corporations Law should not require companies to report any proceedings instituted against the company for any material breach of the Corporations Law or the trade practices law.

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40 Arnold Bloch Leibler, Submission 23, p 6.

41 Coles Myer Ltd, Submission 87, p 4.