Submission of the Class Actions section of Commbar to the Review of changes made by the *Treasury Laws Amendment (2021 Measures No. 1) Act 2021*

A. Introduction and summary

1. This is the submission of the committee of the Class Actions section of Commbar (**Committee**) to the Federal government review (**Review**) of the amendments to Australia's continuous disclosure regime effected by the *Treasury Laws Amendment (2021 Measures No. 1) Act 2021* (**Amendment Act**). This submission addresses questions 4 and 5 set out in the Consultation Paper issued by the Review in November 2023. Those questions are as follows:

   (a) question 4: have you observed any changes in the number and/or type of class actions against disclosing entities for breach of their continuous disclosure obligations since the [Amendment Act] came into effect? If so, what changes have you observed and do you attribute those changes to the [effect of the Amendment Act] or to some other causes?

   (b) question 5: if the [Amendment Act] were to be repealed, would that have:

      (i) a materially positive impact;

      (ii) a materially negative impact; or

      (iii) no material impact at all,

      on the number and/or type of class actions against disclosing entities for breach of their continuous disclosure obligations?

2. Commbar is an association of commercial barristers practising at the Victorian bar. The Committee consists of barristers of varying seniority who practice in class actions,[1] primarily in the Supreme Court of Victoria and Federal Court, but also in the Supreme Courts of other states, and who represent both applicants and respondents in those proceedings.

3. Our answer to question 4 is "no". Our answer to question 5 is that the repeal of the Amendment Act is likely to have no material impact at all on the number and/or type of class actions commenced against disclosing entities. While that is the case, in this paper we identify some of the practical issues raised by the Amendment Act for which applicants in securities actions have had to identify a practical solution. The Amendment Act has also introduced to the continuous disclosure regime a mental element that might, all things being equal, make it more

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[1] We note for completeness that the phrase 'class actions' is an adopted Americanism used to describe representative proceedings commenced under Part IVA of the *Federal Court Act 1974* (Cth), and equivalent procedures included in legislation in Victoria, Western Australia, Queensland and New South Wales. In this submission we adopt that Americanism.

difficult for an applicant to establish its case. By increasing the risk faced by applicants in establishing their claims, the effect of the Amendment Act might also bear upon the prospect of such claims settling prior to trial.

B. The nature of the changes

4. Before addressing questions 4 and 5 in the Consultation Paper, we consider it useful to set out a description of the changes effected by the Amendment Act. Prior to the Amendment Act, equivalent changes were introduced by the *Corporations (Coronavirus Economic Response) Determination (No. 2) 2020* (**Determination**), which had effect from 26 May 2020 to 22 March 2021. Prior to the changes to Part 6C of the *Corporations Act 2001 (Cth)* (**Corporations Act**) that were introduced by the Determination and the Amendment Act, an applicant in a proceeding was required to prove the following elements to establish a contravention by a disclosing entity[2] of its obligation of continuous disclosure, so as to enliven an entitlement to statutory compensation under section 1317HA of the Corporations Act:[3]

   (a) that the entity had information that the provisions of the listing rules of a listing market in relation to that entity (in practice almost always the ASX) required the entity to notify to the market operator;[4] and

   (b) that the information:[5]

      (i) was not generally available; and

      (ii) was information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of enhanced disclosure securities of the entity; and

   (c) that the applicant (and group members) suffered damage, and the "damage resulted from" the entity's contravention of its continuous disclosure obligation.[6]

5. Following the amendments effected by the Amendment Act, the element summarised in paragraph 4(b)(ii) above was replaced with a requirement that the entity knew, or was reckless

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2 "If provisions of the listing rules of a listing market in relation to that entity (such as the ASX) 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": Corporations Act, section 674(1).

3 Corporations Act (as at 1 January 2020), section 674(2).

4 Ibid, section 674(2)(b).

5 Ibid, section 674(2)(c).

6 Corporations Act, section 1317HA(1).

or negligent with respect to whether, the information would, if it were generally available, have a material effect on the price or value of the enhanced disclosure securities of the entity.[7]

6. The effect of the amendment is, at least with respect to the securities of entities listed on the ASX, that an applicant is required to establish *both* that the information is information that a reasonable person would expect to have a material effect on the price or value of the entity's securities (an objective standard), as well as that the entity knew, or was reckless or negligent as to whether, the information would have that effect (which might be described as the "mental element" to import the nomenclature of the Commonwealth *Criminal Code*). That is because the applicant is still required to establish that the entity had information that the provisions of the ASX listing rules required the entity to disclose to the ASX, and Listing Rule 3.1 requires an entity to disclose information that meets the objective standard only.

7. In the result, under the new regime, a disclosing entity might contravene the ASX Listing Rules by failing to disclose particular information (because it is information that a *reasonable person* would expect to have a material effect on the price or value of the entity's securities), but an applicant will not recover compensation for "damage that resulted' from such a contravention unless they can establish that the company knew, or was reckless or negligent as to whether, the information would have that effect. That outcome is apparently contemplated by section 674A(6) of the Corporations Act. We do not comment on the appropriateness of that possibility, save to say that it appears consistent with the apparent concern expressed in the Parliamentary Joint Committee report for what it described as the "apparent detriment" caused by actions brought on behalf of shareholders of disclosing entities, and to erect impediments to the commencement of such proceedings. It does, however, expose investors to the risk that they might purchase securities of an entity at a time when the entity had not disclosed information to the market that it was required to by the Listing Rules, and be unable to seek compensation for any loss that they have suffered by reason of purchasing those securities at a price higher than it would have been had the entity complied with the obligations under the Listing Rules, if they cannot establish (for whatever reason) the mental element. On one view, it could be said that such a result would be inconsistent with the protective purpose of the continuous disclosure regime.

8. Deeming provisions in section 677(2) of the Corporations Act describe circumstances in which an entity will be taken to have known, or to be reckless or negligent as to whether, the information would have a material effect on the price or value of an entity's securities (namely, that the entity knew, or was reckless or negligent as to whether, the information would, or

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7 Corporations Act, section 674A(2)(d).

would be likely to, influence persons who commonly invest in securities to deciding whether to acquire or dispose of the entity's securities). That provision replaces an equivalent deeming provision that applied to the objective standard.

9. The Amendment Act also introduced restrictions on the circumstances in which an entity will be taken to have contravened section 1041H of the Corporations Act, which prohibits a person from engaging in conduct, in relation to a financial product or a financial service, that is misleading or deceptive, or that is likely to mislead or deceive. It does so by stating that, if an entity engaged in conduct that does not contravene section 674A(2), but would if it were necessary only to establish the objective standard, then the "entity's engaging in that conduct does not contravene [section 1041H(1) of the Corporations Act]". The matter has not been tested, but the evident intention of that provision is to limit (if not eliminate) the ability of an applicant to rely on section 1041H(1) as an alternative to the more restrictive requirements of the continuous disclosure regime introduced by the Amendment Act. Equivalent restrictions were introduced in correspondent provisions of the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**).[8] The matter is important, because applicants in securities actions will invariably allege that an entity's failure to disclose material information gave rise to a corresponding contravention of the prohibition on misleading or deceptive conduct (for example, arising from the entity's failure to correct representations with respect to the entity's forecast earnings or the entity's compliance with other regulations).

10. So far as we are aware, there has been no judicial consideration of the operation of the mental element introduced by the Amendment Act. We do note, however, that the trial of a civil penalty claim brought by ASIC against Nuix Ltd commenced in the Federal Court on 21 November 2023. In that proceeding, as we understand it, ASIC alleges that the contraventions of Nuix's continuous disclosure obligations took place (in part) at a time when the Determination was in effect, and ASIC therefore has to establish the mental element. Again as we understand it, ASIC has alleged with respect to the pleaded information in that case that Nuix was negligent as to whether it was material.[9]

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8 ASIC Act, section 12DA(3). We note that no equivalent restraint has been placed on the deployment by applicants of section 1041E(1) of the Corporations Act. That provision, however, includes its own mental element, namely that the person making the representations did not care whether, or knew or ought reasonably to have known that, they were false or misleading.

9 So far as we are aware, ASIC has particularised Nuix's alleged negligence by saying that the materiality of the information was reasonably foreseeable, and that Nuix failed to exercise reasonable care in considering, or in failing properly to consider whether the information was material, and whether to disclose it. We note for completeness that ASIC alleges that the contraventions occurred at a time prior to the Amending Act coming into force, but when the Determination had effect.

C. Answers to the questions

11. Question 4 in the Consultation Paper asks whether we have observed any changes in the number and/or type of class actions against disclosing entities for breach of their disclosure obligations since the Amendment Act came into effect.

12. Before we answer question 4 in the Consultation Paper, we address some practical considerations that have arisen by reason of the Amendment Act and the preceding Determination in pleading continuous disclosure contraventions.

13. *First*, there is uncertainty as to what an applicant must establish in order to prove the mental element with respect to information of which the entity did not have actual awareness, but of which it ought reasonably to have been aware. To establish that a disclosure obligation arises under Listing Rule 3.1, it is necessary to prove that an entity was "aware" of material information. Under the Listing Rules, an entity becomes aware of information if, and as soon as, an officer of the entity has, or *ought reasonably to have*, come into possession of the information in the course of the performance of their duties. The requirement will therefore be satisfied if an applicant can establish that an officer was actually aware of the alleged information, or that they ought reasonably to have been aware of it. In its decision in *Crowley v Worley Ltd* (2022) 293 FCR 438, the Full Court of the Federal Court determined that information that an entity "ought reasonably to have" within the meaning of the Listing Rules includes opinions that an officer ought to have held (but did not in fact hold) by reason of facts known to the officer.[10] The Court determined that "[h]aving regard to the text, context and purpose of section 674 and the Listing Rules an opinion which the [entity] ought to have formed [in light of the information that it in fact had] is itself information of which the entity is deemed to have been 'aware'."[11] There is nothing in the Amendment Act that might, so it seems to us, affect that conclusion.

14. There is some uncertainty as to how an applicant might establish that an entity was negligent or reckless as to whether information constituted by an opinion that its officers had not formed, but that they ought reasonably to have formed in light of the matters of which they were aware, would have had a material effect on the price or value of the entity's securities. For example, in a securities action where an applicant alleges that the alleged information was that it was likely that the entity would not achieve its earnings forecast, which was an opinion that the entity ought to have held (but did not in fact hold), what is the basis on which an applicant will say that a reasonable person in the position of the officers of the company should have concluded

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10 *Crowley v Worley Ltd* (2022) 293 FCR 438, [160(4)] (Perram, Jagot and Murphy JJ).
11 Ibid, [164].

that the information was material? We are aware of various pleading formulations advanced by applicants have that have sought to address that incongruence, and we do not consider that it has presented an impediment to commencing securities actions. The question is one that the Court may need to determine in ASIC's civil penalty claim against Nuix Ltd, on our understanding of the allegations advanced in that proceeding.

15. *Secondly,* ASIC's case against Nuix Ltd (see paragraph 10 above) reveals a further incongruity introduced by the operation of the Determination in particular. Allegations of continuous disclosure contraventions often span significant periods (because an applicant says that information ought to have been disclosed on a particular day, and disclosure does not in fact occur until weeks, months or sometimes years later). Because the Determination had effect only between 26 May 2020 and 22 March 2021, and the Amendment Act did not take effect until 14 August 2021, allegations that span that period might include (or be required to include) alleged contravention of the mental element for part only of the period. While that is the case, repeal of the Amendment Act would not affect that requirement, because any claim that included the period during which the Amendment Act and/or the Determination was in force would still be required to establish the mental element. However, that anomaly could be addressed by legislative reform beyond repealing the Amendment Act.

16. *Thirdly,* there is uncertainty as to how the changes introduced by the Amendment Act will interact with allegations made in securities actions against parties other than the disclosing entity. For example, proceedings frequently include claims against the current and former directors of the disclosing entity, and external advisors, such as auditors and other accountants, solicitors or investment banks. Those claims often concern contraventions alleged against the disclosing entity said to arise from a failure by the entity to prepare financial reports that comply with the accounting standards, or to give a true and fair view of the financial position and performance of a disclosing entity. In those proceedings (and in necessarily short summary), applicants frequently allege that the external advisors made representations to the market with respect to the accuracy and compliance of the entity's financial statements, independent of those made by the disclosing entity, that are said themselves to contravene section 1041H(1) of the Corporations Act and cognate provisions in the ASIC Act and Australian Consumer Law. It does not appear, on its face, that the restriction introduced by the Amendment Act to section 1041H of the Corporations Act and section 12DA of the ASIC Act with respect to claims against a disclosing entity would operate to restrict such claims against parties other than that entity in the same way (because section 1041H(4) and section 12DA(3)

are concerned only with the disclosing entity's "engaging in that conduct",[12] and not the conduct of any other party). That leaves open the prospect of claims being maintained against parties other than the disclosing entity, while the entity itself might avoid liability for essentially the same conduct. While that is the case, it does not appear to us that there has been any material effect on the number or type of securities actions commenced against disclosing entities since the Amendment Act took effect, or of proceedings of the type contemplated by this paragraph.

17. In addition to the above practical observations, we note that as a result of the amendments practitioners have been required to give close consideration to:

    (a) what they might be required to prove, and therefore what evidence they need to file, in order to establish the mental element; and

    (b) how questions of proof in relation to the mental element influence the assessment of prospects of success.

18. As to the first of these matters, in most instances of which we are aware, applicants allege that the entity was 'negligent' as to whether the information was material to the price or value of the entity's securities. Such allegations are ordinarily particularised by saying that, acting reasonably, the directors and other officers of the entity:

    (a) ought to have considered whether their actual knowledge of the pleaded information qualified or contradicted information with respect to the entity of which the market was aware; or

    (b) in circumstances where some directors or officers did not have actual knowledge of the alleged information, the entity failed to ensure that its systems involved processes to ensure that they obtained that information, and considered the matters in (a).

19. In some instances of which we are aware, applicants also allege that the entity was 'reckless' as to the materiality of the pleaded information. Adopting the approach of the criminal law, allegations of recklessness are ordinarily particularised by saying that the objective materiality of the pleaded information meant that it is to be inferred that the entity was aware of a substantial risk that it was material to the price or value of the entity's securities, and that having regard to that risk, it was unjustifiable for the entity not to disclose the information. It

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[12] It seems to us likely that reference to the "person" in section 12DA(3) of the ASIC Act will in most instances be limited to the disclosing entity (because it refers to the person engaging in conduct that "would" contravene section 674A(2), but for the change effected by the Amendment Act). That said, there is some prospect that it would include those would were involved in such a contravention within the meaning of section 79 and section 674A(2) of the Corporations Act.

might be expected that an applicant will more readily establish the mental element of negligence rather than recklessness.

20. In those cases of which we are aware, the inferences of 'negligence' or 'recklessness' are said to arise out of the *same* facts and circumstances identified by an applicant said to establish the entity's knowledge of the information and its objective materiality. In those circumstances, the need to file evidence additional to that which might have been required under the old regime might be limited. One issue on which additional evidence might be required is the content of the "duty" introduced as part of the negligence standard contemplated by the Amendment Act. While that is the case, securities actions often require applicants to file extensive and complex expert evidence, and so we do not consider that the prospect of evidence from a suitably qualified expert relevant to the content of that "duty" is likely to present any real impediment to applicants commencing securities actions.

21. While the evidence required to be filed may not differ, or materially differ, between the old and current regimes, nonetheless we can envisage cases in which it is more difficult to in fact prove the claim at trial as a result of the new mental element. That is because, at least in the abstract, the standard required to establish (for example) that an entity failed to take the steps that a reasonable person would take to avoid the foreseeable risk that the information was material, is likely to be more onerous than that required to establish only that it is information that a reasonable person would expect to be material. Such matters, however, will have to be resolved at trial. Nevertheless, we can also envisage that the more onerous requirement may well influence the assessment of prospects of success, and relatedly, settlement returns to applicants and group members. Generally speaking, it will only be after a respondent has disclosed documentary material to an applicant (in the process of discovery) that the applicant will be in a position to assess, on full information, its prospects of proving the mental element. This may imply that the prospects of proving the mental element is not a significant consideration in deciding whether to commence a class action, provided the applicant's legal advisors are satisfied there is a proper basis to allege negligence on material available upon commencement.

22. While applicants have had to grapple with how they might go about establishing the mental element and what that means for prospects of success, it is not apparent to us that there have been any material number of securities actions that have not been commenced that would have been commenced but for the effect of the Determination or the Amendment Act. Accordingly, the short answer to question 4 is "no".

23. We understand question 5 to ask whether the repeal of the Amendment Act would have any material effect of the number or type of class actions against disclosing entities for breach of

their disclosure obligations? For equivalent reasons to those described above, we consider that the answer to that question is likely to be "no".

24. In addition to the matters described above, we make the following observation. Since the first class actions were commenced against disclosing entities alleging contravention of their continuous disclosure obligations in the early 2000s, such actions have been subject to various legal issues and uncertainties, some of which remain unresolved. Examples include:

    (a) whether restrictions existed in the law as to the funding of such actions by third party funders;

    (b) whether an applicant could commence a proceeding on behalf of only some of the shareholders of the entity who acquired an interest in the entity's securities in the relevant period, limited to those who had entered an agreement with the applicant's litigation funder;

    (c) what the applicant, and group members, had to prove in order to establish a causative link between an entity's contravention of its continuous disclosure obligation, or misleading or deceptive conduct, and the loss or harm suffered. In particular, can an applicant rely on so called "market based" or "active indirect or intermediary"[13] causation?

    (d) whether or not a securities action funded by a litigation funder meets the definition of a managed investment scheme in Chapter 5C of the Corporations Act, and if so what regulatory requirements properly apply to such schemes.

25. To our understanding, uncertainty with respect to those and other matters has not presented a material impediment to the commencement of otherwise meritorious claims. Consistent with that history, it is not apparent to us that any uncertainty occasioned by the Determination or the Amendment Act has had or is likely to have any tempering effect on the number or type of proceedings commenced against disclosing entities, and there is no reason to anticipate that its repeal might materially change the approach of applicants.

DATE: 1 December 2023

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13 *TPT Patrol Pty Ltd v Myer Holdings Ltd* (2019) 293 FCR 29, [1661] – [1663] (Beach J).