SUBMISSION ON REVIEW OF THE OPERATIONS OF THE CHANGES MADE TO THE CONTINUOUS DISCLOSURE REGIME BY THE *TREASURY LAWS AMENDMENT (2021 MEASURES NO.1) ACT 2021* (AMENDING ACT).

FAULT ELEMENTS IN SECURITIES NON-DISCLOSURE LIABILITY

By Dr Michael Duffy[1]

Associate Professor, Director, Corporate Law, Organisation and Litigation (CLOL) Research Group, Monash University Australia

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This submission is produced in response to and to assist the independent review of the operations of the changes made to the continuous disclosure regime by the *Treasury Laws Amendment (2021 Measures No.1) Act 2021.*

It is noted that, in carrying out the review, the reviewer was to have regard to:

- whether the changes made to the continuous disclosure regime are working in support of an efficient, effective and well-informed market
- the effect of the amendments on the quality and nature of disclosures made by listed companies
- continuous disclosure regimes that operate overseas and the extent to which the Australian regime is consistent with those regimes
- whether the amendments have given rise to barriers that may prevent compliance with or enforcement of the continuous disclosure obligations.

The review focuses on the 2021 changes to continuous disclosure (s674(1)-s674A) and misleading and deceptive conduct (s1041H) provisions in the *Corporations Act*[2] and misleading and deceptive conduct (s12DA) in the *ASIC Act* ('the changes') which introduce the requirement of showing fault elements of knowledge, recklessness or negligence of the corporation or its officers in order for liability to attach.

Continuous disclosure

The objective and/or effect of the fault element introduction in 2021 appears to be that:

(a) the former continuous disclosure contravention remains as an offence but is no longer a civil penalty provision while;

(b) a new form of continuous disclosure contravention, involving knowledge, recklessness or negligence is enacted and is a financial services civil penalty provision (entailing a right to compensation under s1317HA) but not an offence.

[1] B. Com, LL. B, LL.M (Melb) Ph.D. (Monash). Associate Professor, Monash Corporate Law, Organisation and Litigation (CLOL) Research Group, Monash Business School, Admitted as Barrister and Solicitor. Former Accredited Commercial Litigation Specialist 1997-2007. The submitters detailed background appears in Annexure One. The views provided here are the writer's own and do not necessarily reflect those of Monash University.

[2] Introduced by the *Treasury Laws Amendment (2021 measures no.1) Bill 2021*(Cth)

Misleading and deceptive conduct

The objective and/or effect of the changes to s1041H and s12DA in 2021 appears to be to introduce the same fault elements where misleading or deceptive conduct claims are brought on the basis of the same conduct as continuous disclosure breaches.

Background

Securities disclosure laws are designed to ensure investors are given the most accurate information on companies that they invest in. Securities claims, including class actions, can seek to recover compensation when this does not occur and, in doing so, hopefully deter future such disclosure breaches.

After amendments to the law in 2021 knowledge, recklessness or negligence of corporations must be proven in such claims for investors to recover and/or for ASIC to obtain relief including damages for breach of a civil penalty obligation (ASIC may still bring criminal action, which pursuant to the Criminal Code would appear to require either intention or recklessness[3] or may bring an infringement notice). Though the relevant laws are about civil penalty provisions, much of the debate has arisen due to the prevalence of private civil actions for damages (especially class actions) pursuant to the availability under s1317HA of compensation for breach of civil penalty provisions (which compensation is available whether or not a declaration of contravention of the civil penalty provision has been made by a court).

The fault elements may be seen to be at least as significant to the position of corporations themselves as to officers given that the former are most often targeted in shareholder class actions[4] (with officers sometime added as defendants). Corporations as defendants themselves (and sometimes insurers) appear to be significant funders of class action damages paid to plaintiffs.[5]

The debate about the changes

There may essentially have been two competing policy views as to these changes which might be summarised as follows.

The view in favour of the changes appears to be that, without requirements of proving fault:

(a) liability was 'strict' and attached too easily to corporations which then became a significant cost to shareholders and insurers in funding settlements to plaintiffs and;

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[3] *Criminal Code* (Cth) s5.6(1), s5.6(2).

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

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

(b) it was too easy for plaintiff lawyers, funders and a group of current or former shareholders to obtain substantial sums[6] in 'opportunistic' class actions against listed corporations and;
(c) listed corporations were being penalised for unintentional and non-negligent behaviour.

The view against the changes appears to be that requirements of proof of fault:

(a) would make such shareholder claims substantially more difficult to prosecute, prove and obtain compensation;
(b) that this then would make it too easy for corporations to have lax or inadequate disclosure practices and;
(c) that this would reduce the rights of redress of investors who had invested substantial sums of money in listed corporations on the basis of what corporations said about themselves, (or failed to say about themselves).

Some options

The main policy options in this area appear to be as follows.

<u>Option One</u>
Leave the changes intact and for a further period such as another two or three years (in addition to the two years that has already passed) to allow a more fulsome consideration of the effects of the changes, including empirical research on court filings, pleadings and decisions and corporate disclosure conduct generally.

<u>Option Two</u>
Repeal the changes and revert to the earlier position which might arguably be described as 'strict liability' or close to 'strict liability' (though see discussion below).

<u>Option Three</u>
Investigate other options including:
(a) Repeal the changes but at the same time investigate and then create a stronger 'safe harbour' defence or 'due diligence' defence for companies and officers that behave reasonably and honestly.
(b) Leave the changes intact for now but at the same time investigate and then create a stronger 'safe harbour' defence or 'due diligence' defence for companies and officers that behave reasonably and honestly, following which the changes would be repealed.

Discussion

Option Two would obviously be most beneficial to plaintiffs/ASIC in making civil penalty actions easier to prove. Option Three would somewhat assist plaintiffs/ASIC in reducing the evidential onus on them to show fault. This change would be averse to defendants but defendants would also benefit in the creation a new defence (but this would also impose on defendants the evidential onus of proving that defence). It is noted that s1317S of the *Corporations Act 2001*(Cth) already allows relief for a defendant from liability where a

[6] Mostly seven, eight or nine figure settlement sums in shareholder class actions. See Peter Cashman & Amelia Simpson, 'Class Actions Research Paper 35 26 October 2020 (PJC Litigation funding and the regulation of the class action industry Submission 55 - Supplementary Submission)

person (which would appear to include a corporation[7]) has acted honestly and ought fairly to be excused from liability. It has been suggested that though this section gives a wide discretion to courts to excuse company officers from liability where it would be unjust or oppressive not to do so, this provides 'relief' rather than a 'defence' as it does not prevent an initial finding of breach of the law.[8]

The submitter has not done an empirical review on whether filings of shareholder class actions has increased or reduced since the legislative changes in 2021. One matter (conundrum) that can be noted in passing in relation to the two-year review period is that a simple analysis of shareholder action filings may not be sufficient – this is because if there had been an observed reduction in the filing of shareholder class actions, that this might be due to a perceived increased difficulty in prosecuting same but might also equally be due to a reduced incidence of non-disclosure activity. Likewise, any observed increase in the number of filings might equally suggest that prosecution of claims has actually become easier, but also that non-disclosure activity has increased. A longer timeframe for review and observation including review of the nature of the conduct alleged in court pleadings and also of other factors affecting the difficulty or otherwise of prosecuting shareholder actions (discussed below) might allow both these questions to be answered more fulsomely.

Strict liability

In discussions of whether the former legislative provisions were 'strict liability' and the meaning of this term, it is also useful to note that strict liability may not be the most severe or 'strict' form of application of a law, given that 'absolute liability' is suggested as the strictest form, at least in criminal law.[9]

Removal of fault elements may be considered to make the laws 'strict liability' as once materiality of information to the share price is proven, liability attaches.[10] Thus, the current position appears to be that, prior to the introduction of fault elements, there was a form of strict liability for nondisclosure of material information that a corporation 'had'. There may however have been a possible requirement of proving some sort of careless or negligent failure in

[7] This relies on interpreting a 'person' as including a corporation as s2C of the *Acts Interpretation 1901* (Cth) does (see also Austin and Ramsay at [16.100]). This is not overly controversial as corporations are legal persons. There is no definition of 'person' in s9 of the Corporations Act other than to say it includes a superannuation fund in ss200 to 200J and in s761A to say it might be a partnership. Austin and Ramsay also footnote dicta in *Blue Metal Industries* [1970] AC 827; (1969) 117 CLR 651 that an Interpretation Act is a drafting convenience and would not be expected to be used to change the character of legislation. Note that S1317G in prescribing penalties for 'persons' who breach civil penalties provides two different amounts – for 'an individual' and for a 'body corporate'.

[8] PJC CFS *Litigation funding and the regulation of the class action industry* December 2020 326-327

[9] Distinction set out in [3.230] *Principles of Criminal Law* by Bronitt and McSherry. It may be then that gradations of liability might be set out from least 'strict' to most 'strict' as follows: (a) criminal fault elements required to be proved – evidential onus on Crown to prove fault through intention or recklessness required; (b) fault required to be proved including negligence option – evidential onus on plaintiff/ASIC to prove fault elements of knowledge, recklessness or negligence; (c) strict liability with a defence - fault elements are not required to be proven but defendant can seek to prove they did not know or were not aware as a defence or due diligence or other reason to be excused (but this evidential onus on defendant); (d) strict liability with no statutory defence provided – fault elements are not required to be proved and proof of physical elements is sufficient; (e) absolute liability - fault elements are not required to be proven, proof of physical elements is sufficient and liability still applies even if no intent, recklessness or negligence.

[10] Subject possibly to the question of liability for non-disclosure of information a corporation does not 'have' but 'should have' had – see discussion in text below.

relation to the extended requirement to disclose information that the corporation ‘should have had’[11] (see the discussion below).[12]

Arguments against

As a general rule however it is suggested that strict liability provisions should be avoided in a general sense as they are unfair on citizens or other legal persons (including private and public organisations with legal personality) who end up being punished or having their property acquired without their being at fault. Though strict or stricter liability may be necessary in some contexts, it is not entirely clear why a stricter approach to corporate disclosure liability would necessarily be justified in the current context. Absent insurance, stricter liability on corporations ultimately falls on shareholders, and given that disclosure laws are there to protect shareholders it may be difficult to argue that one group of shareholders (usually a larger group) should be automatically liable to another (usually smaller) group of shareholders of the same company without fault of the former or of anyone (this issue is also part of the ‘circularity’ problem of shareholder class actions where shareholders are seen to ‘sue themselves’).[13] There might even conceivably be legal or constitutional problems with the Commonwealth in imposing strict liability too, if the terms are not reasonable or ‘just’.[14]

Arguments for

Having said all that, certain strict liability provisions do exist in the criminal law and are also accepted in certain contexts in civil law (such as certain product liability, nuisance, dangerousness and vicarious liability situations[15]) and there may be new areas of law where they will be required to some degree in the future (such as appropriate liability of the creators or owners of artificial intelligence for loss caused by the latter). Strict liability is also sometimes argued for, based on economic arguments about ‘efficient’ economic loss shifting

[11] As to this ‘extended requirement’ under ASX Listing Rules see MJ Duffy, ‘Modifications to continuous disclosure requirements and the role of corporate knowledge, intent, recklessness and negligence in breaches: a discussion’ (2021) 38(2) *Company and Securities Law Journal* 138, 142-143.

[12] If no negligent failure or carelessness by reference to reasonable standards needed to be shown under the old provisions in this regard then it is difficult to see what the ‘should’ requirement on corporations would operate by reference to. Clearly a standard requiring a corporation to have access to and hold perfect information at all times and to foresee the future with complete precision would seem to be an unlikely intent of the legislature. The latter of course brings in the issue of forward-looking statements which are sometimes separately regulated overseas and in Australia may bring in the reasonable grounds doctrine set out in s12BB of the *ASIC Act 2001* (Cth).

[13] These developments have also led to some consternation from trade and financial creditors, who find their normal priority and protection watered down. This has seen some limiting of such claims in the situation of insolvency under *Corporations Act 2001* (Cth) s 563A.

[14] There is an argument, the strength of which is unknown, that, depending on the terms of liability, there may be an associated issue about whether or how far strict liability civil damages provisions could possibly fall foul of constitutional protections against acquisition of property on just terms (see e.g. J E Krier, The Takings-Puzzle Puzzle (1996) 38 *William and Mary Law Review* 1143; R E Walston, ‘The Constitution and Property: Due Process, regulatory Takings and Judicial Takings’ (2001) *Utah Law Review* 379; see also M.J. Duffy ‘Is a cause of action a castle? Statutory choses in action as property and s51(xxxi) of the Constitution’ (2018) 4(1) *Melbourne University Law Review* 1, 12-13, 30-34). The answer to that may be that such laws do not ‘acquire property’ but merely ‘compensate for a loss of property’. Even so, the ‘property’ lost (in this case, usually the loss of a commercial opportunity to buy shares at a lower price) may itself be largely a creation of statute rather than a pre-existing ‘thing’.

[15] Charles E Cantu, 'Distinguishing the Concept of Strict Liability in Tort from Strict Products Liability: Medusa Unveiled' (2003) 33 *University of Memphis Law Review* 823.

in societies (particularly where some parties are insured) and also by weighing of the cost of damage versus the costs of avoiding damage.[16]

In general however, it is submitted that a cautious approach should be taken before the imposition of (return to) strict liability.

Shareholder class actions

The main effect of the changes is likely to be more on shareholder class actions given that they seem to be generally somewhat more numerous than ASIC actions for civil penalties relating to continuous disclosure failures.[17] This is because ASIC tends to use infringement notices more frequently in this area. It is also noted that ASIC will still be able to bring separate criminal proceedings for serious breaches.

This may lead to the associated question of whether shareholder class actions are getting harder or easier to bring and prosecute overall. The following very brief summary is necessarily something of a simplification of developments overall.

Are shareholder class actions becoming harder or easier to prosecute overall?

Since the introduction of class action legislation in 1992 and the first shareholder class action (*King v GIO* in 1999 to 2004[18]), there have been a number of case law and some statutory developments in the class action space some of which have facilitated shareholder class actions and some of which have restrained shareholder class actions. I will endeavour to provide something of a scorecard of the developments in terms of whether they have been favourable to the prosecution of shareholder class actions by lawyers and funders and/or favourable to the investor plaintiffs in such actions (these two beneficiaries are obviously closely linked but, admittedly, not always identical, particularly where there are unrepresented group members[19]). If developments are favourable to 'plaintiffs' in this sense they are given a tick (✓) and those that retard the prosecution of shareholder class actions are given a cross. (**X**). Certain equivocal developments are noted with a question mark (**?**). The submitter accepts that this survey involves value judgements which are no doubt contestable.

The first major shareholder class action, *King v GIO,* [20] was brought under the misleading and deceptive conduct provisions as the continuous disclosure provisions had not yet been enacted. The second major shareholder class action, *Dorajay Pty Ltd v Aristocrat Leisure Ltd,*[21] benefitted from the introduction of the continuous disclosure provisions in the early 2000s as have shareholder class actions since then (✓).

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[16] Guido Calabresit and Jon T. Hirschoff, 'Toward a Test for Strict Liability in Torts' (1972) 81(6) *The Yale Law Journal* 1055.
[17] The author has done some empirical work on these numbers however there has been insufficient time to bring that work up to date – suggesting again the need for more time to consider these issues.
[18] Various decisions Federal Court 1999-2004
[19] This refers to members of the class represented by the plaintiff who variously do not come forward to participate and/or cannot be located and/or do not sign fee and retainer agreements with the class counsel and/or funder.
[20] Various decisions Federal Court 1999-2004
[21] Various decisions Federal Court 2003-2008

The *Sons of Gwalia v Margaretic*[22] decision in the High Court benefitted shareholder class actions in making it clear that shareholders could be creditors of companies for misleading/non-disclosure damages (✓) though the legislature subsequently reduced this benefit somewhat in restoring priority to normal creditor claims in situations of insolvency under s563A of the Corporations Act (**X**).

The widespread (though not universal) acceptance by the courts of 'class closure' to encourage settlements has benefitted identified and represented plaintiffs (✓) (though not necessarily unidentified or unrepresented plaintiffs **X**) but also benefitted defendants in identifying and limiting their potential liability (**X**).

The tentative acceptance of 'market-based causation' in a number of cases whereby plaintiffs do not need to prove individual reliance on misleading/non-disclosure has benefitted plaintiffs (✓) though it's full acceptance by the highest appellate courts is undetermined (**?**).

The acceptance by courts in the earlier 2000s of classes limited to the clients of a particular law firm was of benefit to those plaintiff clients (✓) (but possibly not to other potential plaintiff litigants**?**) but this was then superseded somewhat by the acceptance by courts of a Common Fund Doctrine under which the full class contributed to funders fees which tended to benefit the funding of shareholder class actions (✓). The High Court then curtailed the operation of this doctrine somewhat in *BMW Australia Ltd v Brewster*.[23] (**X**) though the notion that orders can still be made at settlement, though not at commencement, suggests the current position is still reasonably favourable to shareholder class actions. (✓)

The somewhat related issue of frequently competing class actions may be somewhat equivocal for shareholder class actions, (**?**) though if firms are ultimately awarded monopoly carriage this seems to be a considerable prize which may have some consequential benefit to plaintiff litigants. (✓) Against this is some downward effect of competing actions on lawyer and funder fees and commissions perhaps making funding more difficult (or less remunerative) (**X**) though benefitting plaintiff litigants (so long as their cases still run) (✓). Against this also is the increasing tendency of courts to not appoint plaintiff carriage firms to administer settlement schemes which may not benefit those plaintiff firms (**X**) but may benefit litigants themselves through a new layer of competition. (✓)

In Victoria, the statutory introduction of Group Cost Orders allowing solicitor percentage contingency fees has also benefitted the funding of shareholder class actions by law firms. (✓)

The finding in *Brookfield Multiplex Funds Ltd v International Litigation Funding Partners Pty Ltd* [24] that third party funded shareholder class actions were managed investment schemes requiring extensive regulation worked against shareholder class actions for a time (**X**) but this has now been reversed by courts and by the legislature. (✓)

The introduction of fault elements may seem to restrain shareholder class actions somewhat (**X**) though negligence allegations may sometimes have come into these already. In that regard,

[22] (2007) 60 ACSR 292
[23] (2019) 94 ALJR 51 ('*Brewster*'). The Brewster decision was a conjoined appeal from the Federal Court and from the New South Wales Court of Appeal.
[24] (2009) 180 FCR 11.

the extension by ASX Listing Rules Guidance Note 8 and Listing Rule 19.12 of disclosable information from information that a corporation 'has' to information that 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 as an officer of that entity'* would appear to significantly extend liability of corporations. (✓) The court appeared to accept that these provisions were binding in *Crowley v Worley Ltd*[25] (Full Court of the Federal Court), where the court stated further that this included a wider obligation to disclose 'an opinion which the corporation ought to have formed'. (✓) [26]

The tally above suggests that, despite some reverses, the overall trend appears to be that shareholder class actions have **not** become more difficult overall to prosecute over the last two decades, and in fact have been somewhat facilitated by a number of developments.

How hard will shareholder disclosure actions be to prosecute if there are fault elements?

Whilst the fault element of knowledge (or intention) may be quite difficult to prove, recklessness is not quite as difficult, whilst negligence is significantly easier. The last relies relying heavily on objective standards of what a reasonable corporation would have done rather than on proving subjective intentions or state of mind of the corporation. The inclusion of negligence as a sufficient fault element means that the difficulties of knowledge and what is referred to in the US as scienter (see below) may not arise even though fault elements are retained.[27]

Overseas practice

There have various statutory reforms to shareholder class actions in the US and Canada on the fault elements question as follows.

<u>United States</u>

The US developed shareholder class actions well before Australia and these have been a feature of US securities markets for decades. A backlash by corporate business to such suits saw the *Private Securities Litigation Reform Act* (PSLRA)[28] enacted in 1995. It contained several substantive changes to actions brought under the US securities laws.

The PSLRA also heightened the requirements for pleading of securities actions in three ways. Firstly, it required that allegedly false statements be pleaded with particularity so that they alleged the reason why statements were said to be misleading and the facts in support of that allegation. Secondly there was a requirement that the plaintiff alleged that the defendant acted with the required state of mind in knowing that the statement was false or was reckless as to its falsity (claims under the US Rule 10b-5 require the plaintiff to prove that the

[25] *Crowley v Warley Ltd* [2022] FCAFC 33.
[26] *Crowley v Warley Ltd* [2022] FCAFC 33 at [164] per Jagot and Murphy JJ.
[27] Proof of corporate intent is also a subject of some study and advocacy for theories of attribution of human intent to be increasingly replaced by corporate culture factors and 'systems intentionality': see e.g. E Bant, 'Catching the corporate conscience: a new model of "systems intentionality" (2022) *3 Lloyd's Maritime and Commercial Law Quarterly* 467.
[28] Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in. scattered sections of 15 U.S.C.).

defendant acted with intent to deceive, manipulate or defraud – known as 'scienter').[29] In some cases this has been interpreted as requiring that a plaintiff investor must show that the defendant company possessed information, the intentional or reckless non-disclosure of which likely misled investors.[30]

Canada

Canada, like Australia, developed comprehensive statutory procedures to facilitate shareholder and other class actions some time later than the United States (though these developed at a provincial rather than a national level in Canada).[31] The laws appear to provide benefits to both plaintiffs and defendants.[32]

In relation to fault elements, the *Securities Act*[33] of Ontario enacted in 1990 distinguished between misleading/non-disclosure in 'core documents' on the one hand and 'non-core documents' and verbal statements on the other. The former include a prospectus and circulars in relation to take-over bids, issuer bids (buybacks) or rights offerings, management analysis, annual information form, information circular, annual or interim financial statements.[34] In core documents, liability was imposed unless a due diligence defence was established. This appears to be strict liability but with a 'due diligence' defence.[35] Such defence applies where the defendant conducted a reasonable investigation to provide reasonable grounds for a belief that there was no misrepresentation, and that they did not believe that there was misrepresentation.[36] In non-core documents, a plaintiff would need to show knowledge of falsity or gross misconduct.[37] There was also a defence if the defendant corporation could prove that the plaintiff share purchaser knew of the falsity of a representation.[38]

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

[30] *City of Philadelphia v. Fleming Cos*., 264 F.3d at 1261. See eg. Charles F. Hart, "Interpreting the Heightened Pleading of the Scienter Requirement in Private Securities Fraud Litigation: The Tenth Circuit Takes the Middle Ground," (2003) 80(3) *Denver University Law Review* 577-604.

[31] The first province to introduce class action legislation was Quebec in 1978 (*Class action, An Act respecting the*, R.S.Q. c. R-2.1). Ontario followed in 1992 (*Class Proceedings Act*, 1992, S.O. 1992, c. 6), British Columbia in 1996 (*Class Proceedings Act*, R.S.B.C. 1996, c. 50), Saskatchewan in 2001 (*Class Actions Act*, S.S. 2001, c. C-12.01), Newfoundland in 2001 (*Class Actions Act*, S.N.L. 2001, c. C-18.1), Manitoba in 2002 (*Class Proceedings Act*, C.C.S.M. c. C130), Alberta in 2003 (*Class Proceedings Act*, S.A. 2003, c. C-16.5) and New Brunswick in 2006 (*Class Proceedings Act*, S.N.B. 2006, c. C-5.15). Federal procedures were created in 2002 under the *Federal Court Rules* SOR/98-106. See generally A. C. Pritchard; Janis P. Sarra, "Securities Class Actions Move North: A Doctrinal and Empirical Analysis of Securities Class Actions in Canada," (2004) 47(4) Alberta Law Review 881-926.

[32] Securities Act, R.S.O. 1990, c. S.5, ss. 36-50 [OSA]; Securities Amendment Act, 2006, S.A. 2006, c. 30; The Securities Amendment Act, S.M. 2006, c. 11;The Securities Amendment Act, 2007, S.S. 2007, c. 41; An Act to amend the Securities Act and other legislative provisions, S.Q. 2007, c. 15; Securities Amendment Act, 2007, S.B.C. 2007, c. 37.

[33]R.S.O. 1990, c. S.5

[34] R.S.O. 1990, c. S.5, S138.1

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

[36] RSO 1990 ss. 130 (2)-(7)

[37] R.S.O. 1990, c. S.5, S138.4

[38] R.S.O. 1990, c. S.5, S138.4(5)

The laws also placed a cap on damages for ‘unknowing’ conduct (presumably non-disclosure/misleading conduct without knowledge or intent).[39] In that case the cap for damages payable by the issuer company is the greater of 5 per cent of the issuer company’s market capitalization or $1 million. But the caps would not apply where a person made a misrepresentation or non-disclosure with knowledge that it was a misrepresentation or non-disclosure.[40]

Conclusions

In relation to the questions posed, the submitter suggests as follows:

- whether the changes made to the continuous disclosure regime are working in support of an efficient, effective and well-informed market

It is likely way too early to answer this given the slow development of case law based on the changes to the law in 2021 and whatever deterrent or reduced deterrent effect that case law may have on market behaviour.

- the effect of the amendments on the quality and nature of disclosures made by listed companies

Same answer

- continuous disclosure regimes that operate overseas and the extent to which the Australian regime is consistent with those regimes

The US law appears to generally require an element of fault in intention or recklessness (scienter). The Canadian law in Ontario does not require fault elements for liability for misleading/non-disclosure in core documents (prospectus and circulars in relation to take-over bids, buybacks or rights offerings, management analysis, annual information form, information circular, annual or interim financial statements) but does provide a due diligence defence.

- whether the amendments have given rise to barriers that may prevent compliance with or enforcement of the continuous disclosure obligations

The changes will not of themselves directly ‘prevent compliance’. The only question is whether the incentive to comply or deterrence of non-compliance has been reduced. This would involve the possibility that market participants would take the view that the likelihood of being successfully sued has been significantly reduced and are therefore more inclined to not comply with disclosure laws. As infringement notices and criminal liability still exist this may seem somewhat unlikely (though admittedly the financial liability in shareholder class actions usually substantially exceeds liability on an infringement notice).

[39] Sections 138.1 and 138.7.
[40] S138.5-138.7, RSO 1990, c S-5. There are also various other caps in S138.1for directors, influential persons and experts.

Primary submission

It is submitted that two years is too short a period to assess the impact of these changes. Court cases, and class actions in particular tend to take three or four years or more to wind their way through the court system. The effect on market disclosure generally on introducing fault elements to civil penalties for continuous disclosure requires a long chain of causation which may be difficult to establish and may be contestable at the best of times. Presumably the link may involve any reduction to the deterrent effects of changes in the provisions but this may be something difficult to verify or establish causality in relation to, given that the critical data – trial judgements of courts about how the courts are actually treating the new provisions – does not appear to be available over such a short period.

Thus, it is submitted that no realistic conclusions about the effects on markets of introducing fault elements to civil penalty actions can be deduced over such a short period.

Detailed analysis of court filings, allegations in pleadings and judgments (and other market analysis) over a more extended period would be needed for a more fulsome an analysis.

Secondary submission

If the changes are to be repealed and a form of strict liability to be reinstated, fairness may suggest that a more substantive due diligence (safe harbour) defence (perhaps along the lines of laws in Ontario, Canada) should be considered and made available.

It is notable that such a due diligence (business judgment rule) defence is available in relation to the primary corporate governance issue of negligent breach of directors' duties (s180 *Corporations Act*). This is so even though these provisions are not strict liability and instead require objective negligence (carelessness) to be demonstrated. Disclosure actions are therefore already seemingly easier for plaintiffs to sue companies than for companies to sue directors for directors duty breaches, and removal of fault elements without a due diligence defence would make them doubly easier.

Submitter's background

The submitter's background is:

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

He is a lawyer and, before joining Monash, was a Solicitor at Mahony & Galvin (1989-1992) and Senior Associate at Macpherson & Kelley (1992-1999) and Maurice Blackburn Cashman (1999-2004) and a Senior Lawyer with the Australian Securities and Investments Commission (2004-2007). He spent ten years in general commercial litigation acting for plaintiffs and defendants then four years as a plaintiff lawyer in shareholder class actions. At ASIC he worked as a senior enforcement lawyer working on matters including corporate investigation and liquidation, continuous disclosure, insider trading, managed investment schemes and financial services.

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

In 2007-2009 he consulted to the private sector in relation to managed investment schemes and the structure of representative proceedings. In 2017-2020 he received funding from the private profession to research access to justice issues, takeover law in proprietary companies and public interest relief in shareholder class actions.

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