maurice blackburn lawyers

30 November 2023

Director
Continuous Disclosure Review Unit
Market Conduct and Digital Division
The Treasury
Langton Crescent
Parkes ACT 2600

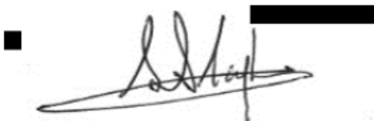
By email: continuousdisclosurereview@treasury.gov.au

Dear Sir/Madam,

We welcome the opportunity to provide feedback in relation to Treasury's Consultation Paper entitled 'Continuous disclosure: Review of changes made by the *Treasury Laws Amendment (2021 Measures No.1) Act 2021*'.

Please do not hesitate to contact me and my colleagues on [redacted] or at [redacted] if we can further assist with the Review Unit's important work.

Yours faithfully,



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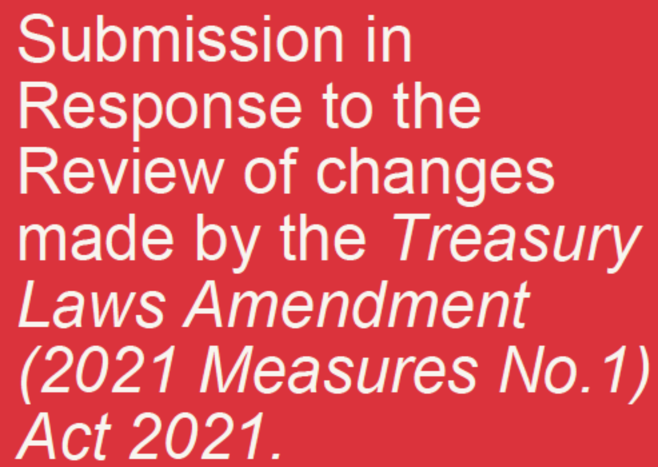

Submission in Response to the Review of changes made by the *Treasury Laws Amendment (2021 Measures No.1) Act 2021.*

November 2023

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Introduction

Maurice Blackburn Pty Ltd is a plaintiff law firm with 34 permanent offices and 30 visiting offices throughout all mainland States and Territories. The firm specialises in class actions (including representative proceedings brought on behalf of investors and consumers of financial products), negligent financial and other advice, personal injuries, abuse law, medical negligence, employment and industrial law, dust diseases and superannuation (particularly total and permanent disability claims).

Maurice Blackburn employs over 1000 staff, including approximately 330 lawyers who provide advice and assistance to thousands of clients each year. The advice services are often provided free of charge as it is firm policy in many areas to give the first consultation for free. The firm also has a substantial social justice practice.

Our Submission

We welcome the opportunity to provide feedback regarding the recent changes to Australia's corporate financial disclosure laws.

Background to the changes

From 2020, the continuous disclosure requirements in the *Corporations Act 2001* (Cth) (the **Corporations Act**) were amended to introduce the underlined words shown below:

> *(2) If:*
>
> > *(a) this subsection applies to a listed disclosing entity; and*
> >
> > *(b) the entity has information that those provisions require the entity to notify to the market operator; and*
> >
> > *(c) that information:*
> >
> > > *(i) is not generally available; and*
> > >
> > > *(ii) ~~is information that a reasonable person would expect~~ the entity knows, or is reckless or negligent with respect to whether, that information would, if it were generally available,~~ to~~ have a material effect on the price or value of ED securities of the entity;*
>
> *the entity must notify the market operator of that information in accordance with those provisions.*

Those changes were first made in response to the Coronavirus crisis in May 2020, relying on emergency powers introduced to deal with the pandemic.[1] Amendments to the Corporations Act made in May 2020 permitted the Minister to exempt classes of persons from compliance with the Act if the Minister considered it was not reasonable to require compliance due to the effects of COVID-19.[2]

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[1] Corporations (Coronavirus Economic Response) Determination (No. 2) 2020, 25 May 2020.

[2] See *Coronavirus Economic Response Package Omnibus Act 2020* (Cth), Sch 8, introducing a new s 1362A to the Corporations Act.

With some non-substantive further amendments, the changes to the continuous disclosure requirements were made permanent with the passage of the Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (Cth). The 2021 bill went further, however, and applied the same language of knowledge, recklessness or negligence to the provisions of the Corporations Act dealing with misleading and deceptive conduct.[3]

These changes were initially cast as a necessary measure to relieve the directors of listed companies from their disclosure obligations in the uncertain economic environment created by the pandemic.[4] The government's justification for making those temporary changes permanent was the majority opinion of the Government controlled Parliamentary Joint Committee on Corporations and Financial Services (**PJC**) report on litigation funding and the regulation of the class action industry, supplemented by some further government analysis directed towards ASIC's enforcement processes and the extension of the amendments to misleading and deceptive conduct.[5]

In summary, our position on the amendments is that they are premised on:

a. a fundamental misunderstanding of the law, in that they proceed from the erroneous starting point that there were no fault elements in the previous legal framework;[6]

b. factual misconceptions and/or outdated information about the impact of shareholders enforcing their legal rights through representative proceedings;[7] and

c. flawed and tendentious analyses of the competing policy considerations at play in promoting a well-functioning and transparent financial market, and the role of private enforcement in supporting the operation of such a market.[8]

Further, we believe that the amendments are drafted in such a way that, even putting to one side the fact that they have their origins in a series of conceptual and factual errors, they could not in any event achieve their intended goal. At best, they will have no effect. The more likely outcome is that they will add to the duration, cost, and complexity of proceedings conducted by shareholders against listed companies, a result which is detrimental to *all* parties, as well as the Court, without having any impact on the incidence of shareholder class actions. At worst, they may have the (apparently unintended) consequence of allowing companies to sidestep liability by pointing the finger at external consultants, and vice versa.

For that reason, Maurice Blackburn's recommendation is that the amendments should be repealed as soon as possible.

We expand on these points over the following pages, in the context of our responses to the specific questions raised by the consultation paper.

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[3] Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (Cth), pages 35 – 36, introducing a new s 1041H(4) to the Corporations Act.

[4] "Temporary changes to continuous disclosure provisions for companies and officers", The Hon J Frydenberg, accessed at <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/temporary-changes-continuous-disclosure-provisions>

[5] Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (Cth), Explanatory Memorandum, 4 – 5, 38 – 46.

[6] See the references to 'strict liability' in the majority report of the PJC at 323, 327, 331, 383, which are premised on a misconception addressed in our response to Question 1.

[7] See, for example, the majority report of the PJC at 349 as it relates to D&O insurance, an issue which is discussed in our response to Questions 6 and 7.

[8] See, in particular, the majority report of the PJC's approach to the supposed economic inefficiency of shareholder class actions at pages 316 - 317, which as discussed in our response to Question 14, fails to engage with the abundant empirical evidence disproving the assumptions on which the majority report of the PJC relies.

Responses to Consultation Questions

1. Impact on market efficiency and effectiveness

Related Questions:

1. Do you consider that the 2021 Amendments have:

(a) resulted in the market for Australian listed securities being materially more efficient, effective, or well-informed;

(b) resulted in the market for Australian listed securities being materially less efficient, effective, or well-informed; or

(c) had no material impact on the efficiency or effectiveness of, or the level of information in, the market for Australian listed securities?

1.1 At present, we believe that the 2021 Amendments have had no real effect on the market for Australian listed securities, other than to create uncertainty.

1.2 That is largely because the wording of the 2021 Amendments makes it unclear whether they have had any impact on the standard of conduct required of listed companies and their officers. As a result, we would expect prudent companies to be operating on the assumption that the amended legislation imposes disclosure requirements which are substantively identical to those imposed prior to the amendments.

1.3 Prior to the amendments, listed companies were required to disclose information that a *reasonable person* would expect to materially affect the price of value of their securities. It follows, of course, that no liability would attach for a failure to disclose information that a reasonable person would not expect to materially affect the price of securities. Similarly, only information of which a company was 'aware' triggered disclosure requirements. Chapter 19 of the ASX Listing Rules defines awareness as including information that company officers *ought reasonably to have come into possession of* in the course of performing their duties. And again, conversely, no liability will attach if undisclosed information exists which was not in the possession of company officers, unless it ought reasonably to have come to their attention.

1.4 As we observed in our 2018 submissions to the Australian Law Reform Commission, the pre-amendment structure effectively mirrors the content of the standard of care in negligence, which is defined by the standard of conduct expected of a reasonable person.[9] For that reason, to describe continuous disclosure obligations either as imposing 'strict liability' or as lacking any fault element, displays a basic misunderstanding of the continuous disclosure provisions as they existed prior to the amendments.[10] The fault standard under the pre-amendment regime was directly analogous to the objective fault standard which characterises the standard of care in negligence. A misunderstanding of that fact was the primary motivation for the amendments.[11]

[9] See, for example, *Gala v Preston* (1991) 172 CLR 243 at 258.

[10] See the majority report of the PJC at 323, 327, 331, 383.

[11] See, for example, the Explanatory Memorandum to the Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (Cth) at 23 – 25. The explanatory memorandum is replete with references to the 2021 Amendments as taking into account the 'state of mind' of a disclosing entity. But negligence is an objective standard which is defined by the fact that, while it may take into account the circumstances of a tortfeasor, it does *not* require evidence as to the tortfeasor's state of mind. Instead it considers how a reasonable person in the circumstances of the tortfeasor would act. See *McHale v Watson* (1966) 115 CLR 199 at 212, 214, 234.

1.5 After the 2021 Amendments were made, the Full Court of the Federal Court of Australia had occasion to consider the scope of the fault elements under the pre-amendment framework in *Crowley v Worley Limited.*[12] In that case, Murphy and Jagot JJ, with whom Perram J agreed, held that when evidence shows that a fact is in existence, that reasonable information systems or management procedures ought to have brought that fact to the attention of a company officer, and that acting reasonably the company officer ought to have understood the significance of that fact, then a disclosure obligation can arise.[13] The Court held that such a standard of fault at the organisational level was important to prevent a situation in which a company would effectively be rewarded for quarantining information from its officers and directors, including by adopting flawed organisational structures.[14] Plainly, the Court did not consider that the continuous disclosure provision operated on a strict liability or 'no fault' basis.

1.6 The 2021 Amendments undermine the careful and considered judicial exposition of the fault elements in the pre-amendment framework, which has been developed in a context specific to, and hence well adapted for, the disclosure obligations of listed entities. By introducing the language of 'negligence', the primary effect of the amendments is to import uncertainty as to what, if anything, the legislature intended to change from the pre-existing standard of conduct. At law, the concept of negligence is broader than a standard of fault. As observed in our submissions on the 2021 bill, it includes principles relating to the circumstances in which a duty of care arises, and a body of case law has developed dealing with that aspect of the doctrine, as well as principles relating to the standard of care, tests for causation and particular categories of loss. These common law principles have, in some cases, been modified by statutory civil liability regimes in each state.[15]

1.7 For the reasons outlined in our submissions on the 2021 bill, it is unlikely the legislature intended to import the entire concept of negligence into the Corporations Act. If that were so, the change would be rendered otiose since the common law has not recognised a duty of care owed by a company to its shareholders, and unless that position were to change, any claim under s 674A of the Corporations Act based on a standard of negligence would fail from the outset.

1.8 The inference must therefore be that the legislature's intention was to amend only the standard of conduct required to establish fault. That inference is strengthened by the explanatory memorandum for the 2021 bill, which, as noted above, discusses the amendment as if it were directed towards introducing a new fault element.[16] But given that the standard of care in negligence is defined by the conduct of a reasonable person, it is unclear that the amendment has achieved anything at all in that respect. Put another way, it is difficult to imagine how actionable conduct under the pre-amendment law, which could only arise from a failure to disclose information a reasonable person would expect to be material, would not also meet the standard of negligence and hence be actionable under the new law.[17]

1.9 Further uncertainty is introduced by the fact that the fault element applies not at the level of disclosure, but at the level of assessment of whether information is material. That is, a company does not become liable under the new regime because it was negligent in failing to disclose information. It becomes liable because it was negligent

[12] [2022] FCAFC 33.
[13] *Crowley v Worley Limited* [2022] FCAFC 33 at [178].
[14] *Crowley v Worley Limited* [2022] FCAFC 33 at [178].
[15] For example, the *Wrongs Act 1958* (Vic) in Victoria and the *Civil Liability Act 2002* (NSW) in New South Wales.
[16] Explanatory Memorandum to the Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (Cth) at 23 – 25.
[17] There is one exception to this position in the context of reliance on third-party consultant reports, as, discussed in our response to Question 5, but the standard of liability for prudent companies based on their own conduct appears to be unchanged.

in assessing whether information would have a material effect on the price of its securities. The textual structure of the amendment, which is limited to assessments of materiality, thus sits incongruously with its stated intention, which was to introduce a fault element to the obligation to disclose.

1.10 For those reasons, notwithstanding the uncertainty introduced by the 2021 Amendments, prudent companies should assume that there has been no change to the fault element attaching to their disclosure obligations, should not have changed their conduct and there would thus have been no material impact at all on the market for Australian-listed securities. If, contrary to that view, there are companies which have reduced the quality or transparency of their disclosures on the assumption that there is a new fault element which excuses them from what would previously have been actionable misconduct, in our view any such change is based on a misunderstanding of the law, and those companies are exposing themselves to increased litigation risk.

2. Impact on nature and quality of disclosures by disclosing entities

Related Questions:

2. Have you observed any changes in the nature and/or quality of disclosures by disclosing entities since the 2021 Amendments came into effect? If so, what changes have you observed and do you attribute those changes to the 2021 Amendments or to some other cause? What data or specific examples can you provide to support your observations?

3. Have the 2021 Amendments affected the ability of investors in Australian listed securities to make informed investment decisions? If so, how?

2.1 In our opinion, and for the reasons set out in our answer to question 1, we have not identified any changes to the disclosure behaviour of disclosing entities as a result of the 2021 Amendments, and they have not had any impact on the ability of investors in Australian listed securities to make informed investment decisions.

3. Impact on class actions

Related Questions:

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 2021 Amendments came into effect? If so, what changes have you observed and do you attribute those changes to the 2021 Amendments or to some other cause? What data or specific examples can you provide to support your observations?

3.1 Data collated by defendant firm King & Wood Mallesons for the period from 2016 to 2023 shows that the frequency of securities litigation has increased each year since the 2021 Amendments received royal assent in August 2021, from a low in the 2020/2021 financial year.[18] This should be unsurprising.

3.2 In our opinion, the temporary amendments made in the midst of the COVID-19 pandemic were unnecessary. Given that the pre-existing regime had appropriate

[18] King & Wood Mallesons, 'The Review – Class Actions in Australia 2022/2023' (2023), p 8.

carve-outs for information that a company's officers could not reasonably be expected to have known, the obvious and publicly acknowledged uncertainty that resulted from the rapidly changing economic situation at the height of COVID-19 made securities litigation less likely, not more likely.

3.3 That view is borne out by the fact that the reduction in securities class actions in financial year 2020/2021 was reversed in following years, even as the temporary changes were made permanent. It was the unprecedented economic environment created by the COVID-19 pandemic which led to a temporary reduction in securities litigation, rather than the amendments to the disclosure regime. For the reasons discussed in our answer to Question 1, contrary to their stated intention, the 2021 Amendments have had no significant effect on the fault element of the disclosure obligations of listed entities themselves.

3.4 For completeness, we note that even if the amendments *had* imposed stricter fault requirements, in our view that would have had little if any impact on the nature and frequency of securities class actions. As we observed in our 2018 submissions to the ALRC, typically the subjective knowledge of particular officers, the adequacy of systems and processes, and the conduct of individuals within a company cannot be clearly ascertained by outsiders until internal documents have been provided in the discovery process, and those documents have been reviewed by the plaintiff's legal representatives. That process typically does not start until after proceedings are commenced, and can involve the review of hundreds of thousands or millions of documents. As a result, changing the fault element would be an ineffective way to change the frequency of occurrence of securities class actions, even if it had some impact on prospects of success.

Related Questions:

5. If the 2021 Amendments were to be repealed, would that have:

(a) a materially positive impact;

(b) a materially negative impact; or

(c) no material impact at all,

on the number and/or type of class actions against disclosing entities for breach of their continuous disclosure obligations? Please explain the reason(s) for your answer.

3.5 While we do not believe the 2021 Amendments have had, or will have, any material impact on the number or type of class actions against disclosing entities, we believe repealing the 2021 Amendments will have a significant, positive impact on the way they are conducted, for two reasons.

3.6 *First*, the uncertain intent and effect of the new language introduced to the *Corporations Act* is likely to give rise to additional cost and delay as parties litigate the question of what effect, if any, the changes have had. It has been observed almost from the outset of Australia's class action regime that respondents have a tendency to rely on ambiguities to generate satellite litigation which frustrates and delays the conduct of substantive trials.[19] The 2021 Amendments are drafted in a way that will inevitably generate ancillary disputes about the legislature's intention, given that it is not at all clear from the text of the provisions themselves.

[19] See, for example, *Bright v Femcare Limited* [2002] FCAFC 243 at [160].

3.7 *Secondly*, and most importantly, while the 2021 Amendments are, in our opinion, ineffective in making any adjustment to the standard of conduct expected of disclosing entities themselves, they may have an apparently unintended consequence by allowing companies to sidestep liability by relying on external consultants or auditors, and in turn relieving those external auditors of liability. This point was canvassed in our submissions on the 2021 bill, but we restate it briefly here.

3.8 In circumstances where a company's officers purport to rely on an external report, such as an auditor's report or commissioned 'independent' review, it would be possible for a company to claim that it was not negligent to do so. This argument could be advanced even where, for example, there is a material misstatement of a company's financial accounts that is ultimately attributable to the external agency, resulting in a failure to disclose the true position. In such a situation, where the auditor's liability generally arises from being 'involved' in a contravention, the lack of a primary contravention on the part of the company would allow all parties to escape liability. In effect, companies could structure their disclosures in such a way as to 'outsource' misconduct, which would be inconsistent with the fundamental purposes of requiring listed companies to publish audited financial statements.

3.9 In just the last few months, some of the most prominent audit firms have been caught up in major scandals following revelations emerging from the Senate's inquiry into consulting firms, which is due to deliver its final report in March 2024. In these circumstances, the observations in our submissions on the 2021 Amendments take on a renewed force. In our view, providing a pathway for listed companies to escape liability by strategic and self-serving use of external consultants' reports runs contrary to sound policy by providing an avenue for companies to compartmentalise and avoid liability for misconduct, and those policy considerations have become even more acute following the information that has emerged from the Senate's inquiry into consulting firms.

4. Impact on D&O insurance

Related Questions:

6. Have you observed any changes in the availability and/or cost of D&O insurance for disclosing entities since the 2021 Amendments came into effect? If so, what changes have you observed and do you attribute those changes to the 2021 Amendments or to some other cause? What data or specific examples can you provide to support your observations?

7. If the 2021 Amendments were to be repealed, would that have:

(a) a materially positive impact;

(b) a materially negative impact; or

(c) no material impact at all,

on the availability and/or cost of D&O insurance for disclosing entities?

4.1 Given that the number of securities class actions appears to have been unaffected by the passage of the 2021 Amendments, changes to the availability and/or cost of D&O insurance cannot be attributable to changes in litigation risk.

4.2 Our view remains that the changes in the cost of D&O insurance in the period prior to 2018, which were cited as a major motivation of the recommendations of the majority report of the Parliamentary Joint Committee,[20] were not driven by litigation risk. In our view, based on discussions with those who occupied senior roles within the insurance industry at the time, the market for D&O insurance in the period from 2010 – 2016 was characterised by oversupply, leading to heightened competition which drove premiums below sustainable rates.

4.3 Starting from 2016, this pricing trend was corrected, and at the same time mergers between some major insurers, along with withdrawal from the Australian market by others, led to a relative undersupply of providers. This reduction in supply, resulting from structural changes to the insurance market, coupled with consistent demand permitted opportunistic pricing on the part of insurance providers in the period from 2016 onwards.

4.4 In the circumstances, it is important not to confuse correlation with causation. As we discuss further in our concluding remarks in response to question 14, in a number of contexts the majority report of the Parliamentary Joint Committee uncritically accepted contentious assertions, then relied on those assertions as the justification for the 2021 Amendments. When carefully examined, the purported relationship between trends in securities class actions and D&O premiums presents one such example.

5. Consistency with other markets

Related Questions:

8. Would you say that the continuous disclosure regime in the Corporations Act following the 2021 Amendments is:

(a) materially tougher than;

(b) materially more lenient than; or

(c) in broad alignment with,

the disclosure regimes that operate in major overseas markets? Please explain the reason(s) for your answer.

9. The PJC Report stated that the 2021 Amendments would bring Australia's continuous disclosure regime closer to the regimes in comparable jurisdictions such as the United States and United Kingdom. ASIC, however, has stated that introducing a fault-based framework for ASIC enforcement litigation may have placed Australia out of step with the United States and the United Kingdom, where it appears regulators can take enforcement action without establishing fault. Do you agree with the PJC Report or with ASIC in this regard? Please explain the reason(s) for your answer.

5.1 As discussed in our responses to Questions 1 to 7, other than introducing uncertainty about the intention of the legislature, it is not clear that the 2021 Amendments have had any effect on the standard of conduct expect of disclosing entities themselves. Subject to the concerns raised in our response to Question 5 regarding the potential to sidestep liability by using external consultants, our response is therefore that the Australian continuous disclosure regime was previously, and remains, comparable to

[20] Majority Report of the PJC, p 320 – 321, 349.

those of Canada, South Africa and Hong Kong, but more rigorous than those of the US and the UK, at least in terms of private rights of recovery.[21]

5.2 The situation in the US provides an illustrative example, and it exposes a significant contradiction in the reasoning that underpins the 2021 Amendments. The US has the most stringent fault standard of any comparable disclosure regime other than the United Kingdom, which has no functioning class action regime available to shareholders. In the US, it is necessary for investors to demonstrate with cogent and compelling evidence that a contravention was accompanied by subjective fraudulent intent.[22] In fact, the shorthand for such litigation is "securities fraud". Liability typically attaches only to positive misstatements, rather than breaches of continuous disclosure obligations. Notwithstanding the greater stringency, however, securities class actions in the United States are far more common than in either Australia or Canada,[23] each of which has more rigorous disclosure obligations and a lower threshold to establish actionable misconduct.

5.3 In our view, the explanation for this apparent paradox is clear when one considers the empirical evidence from comparative analyses of the two disclosure environments. The less rigorous disclosure requirements in the United States, and the additional hurdles to private redress in that jurisdiction, lead to a market which is less stable and not as well-informed, and is therefore subject to more frequent earnings surprises.[24] And as we have noted in our answer to question 4, class action proceedings are commenced without the benefit of complete discovery, prompted by earnings surprises and the objective question of whether, from an *outsider's* perspective, it appears reasonable that a company or its officer ought to have disclosed information earlier. It is only after proceedings have been commenced that detailed insider information as to subjective knowledge is made available.

5.4 Thus, weakened liability for disclosure breaches as a result of a heightened fault element leads to a less informed market, more earnings surprises, more conduct leading to shareholder harm, and more litigation as a consequence of that harm.

5.5 As to the impact of a heightened fault standard in the context of regulatory action, we agree with ASIC that it places Australia out of step with other jurisdictions. Perhaps more fundamentally, if it is accepted (as was the intention of the legislature) that the 2021 Amendments have been effective in imposing an additional fault element, the consequence would be that there is now a higher burden to establishing civil liability under s 674A of the Corporations Act than to establishing criminal liability under s 674 of the Corporations Act. That runs contrary to the traditional legal principle that punitive, criminal sanctions should be reserved for the most egregious conduct, while restorative remedies should be more readily available.

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[21] See, for example, the table reproduced in the majority report of the PJC at 333 – 334.
[22] *Tellabs Inv v Makor Issues & Rights Ltd* (2007) 127 S. Ct. 2499 at 2509-2510.
[23] See discussion in Vince Morabito, 'Shareholder class actions in Australia - myths v facts' (2019) at 13 - 16, showing that the *total* number of class actions filed in Australia in 2017 – 2019 was approximately equal to the average number of cases filed in just the single Canadian province of Ontario, and far lower than the peak filing rates in that province. Since 2019, the number of class actions issued in Australia has declined somewhat: see King & Wood Mallesons, 'The Review – Class Actions in Australia 2022/2023' (2023), p 6. In the period 2018/2019, shareholder class actions accounted for 19 of the 59 class actions filed, or 32%. In the same period 428 federal securities class actions were filed in the United States: see Cornerstone Research, "Securities Class Action Filings – 2019 Year in Review' at 1.
[24] S Brown and C Shekhar, "Continuous Disclosure in Australia and the United States: A Comparative Analysis", August 2016, 23-26.

Related Questions:

10. If the 2021 Amendments were to be repealed, would that have:

(a) a materially positive impact;

(b) a materially negative impact; or

(c) no material impact at all, on the competitiveness of Australian equity markets to attract new listings compared to major overseas equities markets?

5.6 In our view, based on the present state of the law, repealing the 2021 Amendments would have a positive effect on the ability of Australian equity markets to attract new listings. That is because, for the reasons outlined in our response to Question 1, given the drafting of the amendment, prudent companies should be operating on the assumption that their own disclosure obligations have not changed substantively.

5.7 The only change achieved by the 2021 Amendments was to introduce a significant element of uncertainty as to what interpretive principles will apply to the new standard, and to bring into question the applicability of judicial exposition of the pre-amendment laws. To the extent that listing entities look for certainty and predictability in understanding their regulatory obligations, the 2021 Amendments can only have had a negative impact on the attractiveness of Australian equity markets.

5.8 As we have noted in our answer to Question 5, the 2021 Amendments could enable listed entities to avoid liability by relying on inaccurate or misleading reports from third party consulting firms, which creates the risk of a less transparent market. In general, we would caution against an implicit assumption that the competitiveness of a financial market is in some way undermined by the adoption of a rigorous disclosure regime. On the contrary, in a transparent market with a robust disclosure environment, the cost of capital will be reduced for all market participants.[25] Strong disclosure regulations create a more attractive environment for investors, and hence for companies seeking to attract investment.

6. Compliance and enforcement

Related Questions:

11. Have the 2021 Amendments given rise to barriers that may hinder the effective enforcement by ASIC of a disclosing entity's continuous disclosure obligations under the Corporations Act. If so, what are those barriers and how do you think they should be addressed?

12. Have you observed any changes in the number and/or effectiveness of enforcement actions by ASIC against disclosing entities for breach of their continuous disclosure obligations since the 2021 Amendments came into effect? If so, what changes have you observed and do you attribute those changes to the 2021 Amendments or to some other cause? What data or specific examples can you provide to support your observations?

13. If the 2021 Amendments were to be repealed, would that have:

[25] See, for example, Richard Lambert, Christian Leuz and Robert Verecchia, 'Accounting Information, Disclosure and the Cost of Capital' (2007) 45(2) *Journal of Accounting Research* at 35 – 36.

(a) a materially positive impact;

(b) a materially negative impact; or

(c) no material impact at all,

on the capacity of ASIC to take effective enforcement action against disclosing entities for breach of their continuous disclosure obligations?

6.1 Our view is that private actions on behalf of shareholders are an important complement to the regulatory tools available to ASIC. In 2012 Greg Medcraft, then Chairman of ASIC, described class actions as a 'good, market-driven solution' and observed that they enabled ASIC to divert its resources elsewhere if wrongdoing was likely to be addressed by private litigation. That position was reiterated in 2014 following cuts to ASIC's budget, which the Chairman anticipated would lead to an increasingly prominent role for private litigation in enforcing good market conduct.[26]

6.2 Similarly, at a Senate Estimates Committee hearing in 2017, officers of ASIC explained the decision to accept only partial compensation for consumers as motivated in part by a lack of resources and the fact that the uncompensated subgroup could seek redress through alternative means, including a class action. Officers of ASIC noted that the agency's primary focus was on encouraging behavioural change through a range of methods including non-compensatory enforcement techniques such as enforceable undertakings. Where that can be achieved quickly, it was not considered a priority for ASIC to devote significant time and resources to attempting to recover full compensation.[27]

6.3 In that regard, we fundamentally disagree with the majority position of the joint committee, which underpinned its reasoning on the 2021 Amendments, that "shareholder class actions are generally economically inefficient and not in the public interest".[28] Our view, which is consistent with the views regularly expressed by regulators themselves, is that shareholder class actions are an effective market-driven solution which frees up regulators to focus on investigating misconduct, imposing punitive sanctions such as civil penalties in the case of particularly egregious misconduct, and engaging in educative and persuasive non-enforcement activities.

6.4 A significant driving force behind the 2021 Amendments was to curtail the availability of private enforcement of shareholder rights through class actions.[29] If that goal had been executed successfully, in our view, that would have placed an additional enforcement burden on ASIC, which would require substantial additional funding in order to maintain the current levels of market transparency and efficiency which characterise the ASX.

6.5 We have noted significant changes to ASIC's enforcement approach over the years, however those have been driven primarily by changes in government policy rather than amendments to the disclosure regime.

6.6 In August 2019, ASIC committed to implementing the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, developing a new 'Why not litigate?' enforcement strategy, and establishing an Office of Enforcement to oversee its focus on 'increased and accelerated' Court-

[26]Shaun Drummond, 'ASIC Chief Sets Sights on Financial Advisors', *The Age* (Melbourne), 25 June 2014, 24.
[27] Evidence to Senate Economics Legislation Committee, Parliament of Australia, Canberra, 2 March 2017, 11-13 (Tim Mullaly, Senior Executive Leader, Australian Securities and Investments Commission).
[28] Majority report of the PJC at 348.
[29] See, for example, the majority report of the PJC at 349 – 350.

based outcomes.[30] However, in August 2021, ASIC released a Statement of Intent (responding to a Commonwealth statement of expectations) in which enforcement has again taken a back seat. The new Statement of Intent emphasised ASIC's desire to avoid hampering economic activity, and refocuses on the educative and cooperative aspects of ASIC's role.[31] It is this erratic approach to regulatory policy which appears to form the primary determinant of ASIC's enforcement strategy at any given time.

6.7 In our view, repealing the 2021 Amendments would have a positive effect on the capacity of ASIC to take enforcement action, primarily by restoring clarity to the circumstances in which market-based private litigation can act as a complement to regulatory action.

7. Other matters

Related Questions:

14. Are there any other matters concerning the 2021 Amendments that you would like to see addressed in the Review?

7.1 In our view, the 2021 Amendments were the culmination of a process which was characterised by a regrettable lack of engagement with evidence-based analysis of the importance of a robust disclosure regime in ensuring market integrity, and the role for private enforcement of shareholder rights within that regime.

Empirical evidence of the effect of class actions on shareholder value

7.2 Several of the justifications for the 2021 Amendments proceeded from controversial and questionable assumptions, which were uncritically accepted in the majority report of the Parliamentary Joint Committee. By way of example, the majority report cited a theoretical construct, the so-called 'circularity problem', advanced by critics of private litigation brought on behalf of shareholders. In brief, the 'circularity problem' suggests that shareholder class actions are inutile on the basis that they effectively involve one group of shareholders paying compensation to another group of shareholders.[32] However the reasoning of the majority did not engage at all with the arguments which, in our view, clearly demonstrate that perceptions of a circularity problem are based on unsound reasoning and are unsupported by empirical data.

7.3 To begin with, the fact that one group of shareholders may pay out to another group of shareholders is irrelevant to the nature of the conduct that is targeted by disclosure provisions. The most important economic effect of shareholder class actions is that they encourage transparency and disclosure, preventing companies from benefiting when they conceal material information from the market. Investors who are trading in an artificially distorted market, and thus by definition are unable to make informed investment decisions, are the victims of actionable misconduct, because, in effect, they have overpaid for their shares. If, when misconduct comes to light, a subset of those investors choose to retain shares in the company, or to acquire shares (often at a lower price), they do so knowing that the misconduct has occurred, and factoring that knowledge into their trading decisions. Likewise, if another subset of investors no longer wish to remain invested in a company, they have an opportunity to vote with

[30] *ASIC Corporate Plan 2019 – 2023* (August 2019), p 2.
[31] ASIC, *Statement of Intent* (August 2021) (https://asic.gov.au/about-asic/what-we-do/how-we-operate/accountability-and-reporting/statements-of-expectations-and-intent/statement-of-intent-australian-securities-and-investments-commission-august-2021/)
[32] Majority report of the PJC at 316 – 317, 348.

their feet. The fundamental point is that both of those subsets of investors (who proponents of the 'circularity problem' assert are paying compensation to earlier investors) are able to make a fully informed decision, based on the company's true position - an opportunity that had previously been precluded by the company's misconduct.

7.4 And indeed, there may be good reasons for investors to hold or take up a position in a listed company after revelations of misconduct have come to light. Empirical research has shown that shareholder class actions have a positive effect on long-term shareholder value. The commencement of proceedings may, and often does, coincide with a declining share price, but it is frequently the case that the declining trend starts *before* the prospect of litigation is raised. In other words, the share price decline, on one hand, and heightened litigation risk on the other, are better understood as independent consequences arising from the company's contravening conduct.[33] That phenomenon is consistent with research that has shown that even where a share price decline follows the announcement of litigation, it is the underlying misconduct, and not the commencement of proceedings itself, that is the main driver of the decline in share price.[34] In the longer term, research shows that the effect of shareholder class actions on company performance is positive, with companies treating litigation as a catalyst to improve their operations.[35] An examination of the empirical evidence thus demonstrates the flawed assumptions underpinning the purported problem of circularity, which was cited by the majority report of the Parliamentary Joint Committee as justifying the 2021 Amendments.

7.5 In our opinion, the present review, and in particular the appointment of a subject-matter expert to lead the review, represents a timely opportunity to restore some rigorous, evidence-based decision making to an area of the law which has regrettably been characterised by tendentious and politically-charged policymaking.

Developments since 2021

7.6 In the years since the 2021 Amendments, there have been several developments that have underscored or enhanced the effectiveness of the pre-2021 disclosure regime. In our response to Question 1, we have noted the significance of the decision in *Crowley v Worley Limited*, which brought new clarity to the circumstances in which a large organisation such as a listed company can reasonably be held liable for disclosure breaches. The stability afforded by the continued judicial development of the law in cases such as *Crowley v Worley* has been thrown into doubt by the introduction of new (and unclear) language with the 2021 Amendments.

7.7 Meanwhile, the availability of group costs orders in Victorian class actions,[36] and the prospect of analogous solicitors' common fund orders in the Federal jurisdiction,[37] mean that cases can be run more cheaply and efficiently, in many cases without requiring a third-party litigation funder. This means that another of the rationales behind the implementation of the 2021 Amendments has been overtaken by the pragmatic and incremental development of the class actions regime.

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[33] M McCarten and I Diaz-Rainey, "Securities class actions and operating performance" (2017) 43(1) *Managerial Finance* 44, 56.
[34] P Lieser and S Kolaric, "Securities class action litigation, defendant stock price revaluation, and industry spillover effects" (Paper presented at the European Financial Management Symposium, Basel, 29 June 2016) 34.
[35] Ibid 51, 56.
[36] See s 33ZDA of the *Supreme Court Act 1986* (Vic).
[37] See, for example, *R&B Investments Pty Ltd (Trustee) v Blue Sky Alternative Investments Limited (Administrators Appointed) (in liq) (Carriage Application No 2)* [2023] FCA 142 at [17] to [18].

Misrepresentation

7.8 Finally, we note that the 2021 Amendments introduced the language of 'negligence, recklessness and knowledge' into the standard of liability for positively misleading statements. As we have noted in our response to Question 5, the most concerning feature of the 2021 Amendments is the possibility that they will become a mechanism for listed companies to avoid liability by pointing the finger and reports by consulting firms. This problem is particularly acute in the context of positive statements, where, as we noted in our submissions on the 2021 Amendments, material misstatements of financial reports may become impossible to pursue unless a company can be shown to have actively misled its auditors.