Continuous Disclosure: Review of liabilities for failure to meet obligations

Summary

It is not feasible to, in isolation, review the 2001 Amendments to the continuous disclosure regime without considering the broader operation of Australia's continuous disclosure laws and the impact of those amendments on its operation.

The Continuous Disclosure framework that operated in Australia, prior to the changes introduced into law in 2021, already failed to adequately ensure a fully-informed market and protect investors. Therefore, weakening that legal framework was, and remains, a retrograde step as it has reduced the incentives for directors to exercise an appropriate level of due diligence around managing their continuous disclosure obligations.

Background

There are four fundamental components for an effective continuous disclosure regime to adequately protect investors' interests and drive an efficient market.

These components are:
- clear and concise guidance as to the information required to be disclosed;
- a well-resourced and effective lead regulator being the Australian Securities and Investment Commission (ASIC) augmented by the Australian Securities Exchange (ASX);
- significant financial penalties for companies relative to the size of their market capitalisation or turnover, and significant penalties for executives and directors for failing to appropriately exercise their fiduciary duty; and
- a balanced legal framework, which is not biased in favour of defendants at the expense of litigants or vice versa.

There is room for substantial improvements in several of these pillars, namely an effective regulator and ensuring a balanced legal framework.

The objective of having meaningful penalties in place is to act as a deterrent. If the system is working well, their application should be infrequent.

The changes to Continuous Disclosure laws that were brought into effect in 2021 provide greater protection for companies, directors and its officers by raising the threshold of proof so that "an entity and its officers will only be liable for civil penalty proceedings where there is a knowing failure to comply or recklessness or negligence while maintaining the integrity relating to the disclosure of price sensitive information to the market".

Consequently, the pendulum has swung toward protecting directors at the expense of Australian investors. This imbalance should be redressed. Companies, directors and officers should be held to account for their actions or inaction.

In my view, ASIC does not have, and is unlikely to have, the necessary resources to identify, investigate or prosecute all instances of failures of continuous disclosure obligations. This places a greater reliance on companies, directors and officers to ensure their own adherence to these obligations.

Clayton Utz stated that the 2021 reforms "…will also mitigate the risk of listed entities and their officers being subject to opportunistic class actions…"[1]. Class actions have a role in the efficiency of financial markets and augment the functioning of ASIC. Albeit, class actions litigators tend to focus on ASX200 companies where the magnitude of potential court settlements make it financially attractive to the litigants. As of 13th October 2023, there were 2,401[2] companies listed on the ASX. This means that investors in approximately 2,200 companies are heavily reliant on an efficient and effective regulatory environment to protect their investments.

Failures in continuous disclosure

There are limited legal judgements concerning failures of continuous disclosure, which is probably reflective of a resource-constrained regulator and the legal hurdles to be cleared rather than an absence of disclosure breaches. The recent judgements support the assertion that executives and or directors have made conscious decisions not to disclosure information, which should have resulted in significant consequences for mis-leading the market.

In August 2015, ANZ Banking Group failed in its fiduciary duty to keep the market fully informed when it determined not to announce a $790 million underwriting shortfall on a $2.5 billion institutional share placement.

In October 2023, Federal Court Justice Mark Moshinsky stated that "The court has concluded that ANZ breached its continuous disclosure obligations". Justice Moshinsky's judgement stated that Shane Elliot, ANZ's CEO (and a director) was advised of the $790 million underwriting shortfall prior to the ASX announcement being released prior to trading recommencing on 7th August 2015. The CEO, and possibly the remaining directors, may have failed their continuous disclosure obligations. However, ASIC opted to run the simplest case, which excluded naming any or all directors as defendants. As a result, the possible failure by directors to exercise their fiduciary duty in this matter was not determined and there have been no consequences.

Based upon the laws in force at the time the maximum fine would be $1 million. For a company that reported a Statutory Profit for FY2015 of $7.5 billion, the magnitude of any fine associated with this breach is immaterial and almost inconsequential. The benefits of non-disclosure appear to have outweighed the financial or other penalties involved.

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[1] https://www.claytonutz.com/knowledge/2021/august/significant-reforms-to-the-australian-continuous-disclosure-regime-are-now-law-a-guide-for-listed-entities-and-their-officers
[2] https://www.marketindex.com.au/asx-listed-companies

A court ruling some eight years after the event, as well as no repercussions for the executives involved in the failure to disclose price sensitive information does little to enhance ongoing confidence in the market's operation.

The reasonable investor would be in strong agreement with Justice Moshinsky's judgement that ANZ clearly failed in its continuous disclosure obligations. However, given the 2021 amendments it is highly questionable given the same set of circumstances as to whether ASIC would have commenced any legal action, or ultimately been successful in court.

In 2019, the maximum penalty that can be levelled against a body corporate increased to the greatest of:

- 50,000 penalty units (currently $15.65 million),
- three times the benefit obtained and detriment avoided, or
- 10% of annual turnover, capped at 2.5 million penalty units (currently $782.5 million)

The increase in penalties to $1.05 million for an individual is potentially more than negated by the greater burden of proof required, which was introduced in 2021.

Investors would have expected that ANZ, one of the ASX's 10 largest companies, run by high-calibre executives and directors adhere to the highest standards of compliance with continuous disclosure obligations. Lower standards of corporate governance and compliance around continuous disclosure is more likely to occur in the bottom four quintiles of listed companies.

The current legal framework inadequately incentivises individual directors to exercise an appropriate level of due diligence in their deliberations due to:

- the low likelihood of breaches being identified;
- a low probability of being prosecuted, particularly in light of the changes in law in 2021;
- limited personal repercussions in the event of an adverse regulatory finding; and
- protection provided by Directors & Officers insurance, which is paid for by shareholders.

Conclusion

The increased threshold of proof legislated in 2021 may have been justified if there had been egregious examples of directors being found guilty for minor transgressions. However, for legislation to have been passed in an attempt to stop a rise in class actions and provide a significant additional layer of protection for directors, potentially at the expense of protecting investors' interests, is highly questionable.

Class action litigants will only undertake legal action if they perceive a high probability of success and where a significant financial loss has been incurred. These litigants fulfill a role, alongside ASIC, in driving positive corporate governance outcomes relating to continuous disclosure.

Opportunistic class actions will be dealt with in court, where companies confident in having met their continuous disclosure obligations are likely to win. For example, in October 2020, Worley Limited successfully defended a class action around alleged breaches in continuous disclosure obligations.

If directors and companies fulfilled their continuous disclosure obligations diligently there would be few class actions. Until then investors need to be protected with legislation that appropriately incentivises companies and directors to exercise due diligence.

The economic benefit to Australia of an efficient, fair and informed market is significant and warrants amending the liabilities and laws governing continuous disclosure breaches.

13th November 2023