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By email

Dear Director

Consultation paper 'Continuous disclosure: Review of changes made by the *Treasury Laws Amendment (2021 Measures No. 1) Act 2021*' Submission of Herbert Smith Freehills

This is our submission made in response to the consultation paper released by Treasury in November 2023 regarding the reforms made to the Australian continuous disclosure regime in 2021, which is titled 'Continuous disclosure: Review of changes made by the *Treasury Laws Amendment (2021 Measures No. 1) Act 2021*' (the **Consultation Paper**).

In our view, the 2021 Amendments have had a positive impact on the Australian continuous disclosure regime. As such, we strongly support their retention.

1 Our experience with the continuous disclosure regime

Herbert Smith Freehills has a rich history. As a firm, we have been assisting clients to navigate the Australian continuous disclosure regime since it was first introduced.

We have a wealth of experience in this area and regularly advise ASX-listed entities on compliance with their continuous disclosure and reporting obligations under the *Corporations Act 2001* (Cth) (the **Corporations Act**) and ASX Listing Rules. We have also acted on many of Australia's largest and most complicated corporate transactions, including several involving ASX-listed entities.

We recently released *Bootmakers, Boards and Rogues*, a leading book on contemporary issues in Australian corporate and securities law. Chapter 6 of the book, in particular, examines the current Australian continuous disclosure regime, including the reforms referred to in the Consultation Paper along with some potential options for further reform.

2 Background

Continuous disclosure has become an increasingly prevalent issue in Australian corporate and securities law. For many companies, compliance with their continuous disclosure obligations is a daily concern which is front of mind for their directors, officers, employees and advisers.

Australia's pre-2020 disclosure regime set a high bar for continuous disclosure and was widely regarded as one of the toughest disclosure regimes in the world. It created challenges for company officers in making determinations on continuous disclosure matters, particularly in circumstances where quick judgement calls were required.

In May 2020, the Federal Government first introduced temporary changes to the continuous disclosure regime.[1] These changes were made permanent in 2021 (the **2021 Amendments**).[2] The 2021 Amendments effectively incorporated a fault element into Australia's continuous disclosure laws.[3]

Under the new ss 674A and 675A of the Corporations Act, a company or its officers will only be liable for civil penalty proceedings in respect of a breach of their continuous disclosure obligations where it can be shown they have acted with "knowledge, recklessness or negligence" as to whether certain information would have a material effect on the price or value of the securities of the relevant entity.[4]

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[1] *Corporations (Coronavirus Economic Response) Determination (No 2) 2020* (Cth).

[2] *Treasury Laws Amendment (2021 Measures No. 1) Act 2021* (Cth).

[3] See, eg, Michael J Duffy, 'Modifications to Continuous Disclosure Requirements and the Role of Corporate Knowledge, Intent, Recklessness and Negligence in Breaches: A Discussion' (2021) 38 *Company and Securities Law Journal* 138.

[4] *Treasury Laws Amendment (2021 Measures No 1) Act 2021* (Cth); *Corporations Act 2001* (Cth) ss 674A, 675A.

The stated rationale for introducing the fault element was to:

- more closely align Australia's continuous disclosure regime with that in place in the United Kingdom (the **UK**) and United States (the **US**); and
- mitigate the risk of companies and officers being subject to opportunistic class actions, following criticism of the strict liability nature of continuous disclosure requirements.[5]

3 Response to Consultation Paper

In our view, the 2021 Amendments have had a positive impact on the Australian continuous disclosure regime. As such, we strongly support their retention.

We set out below some of the key reasons for our view.

3.1 Greater balance between competing policy demands

A strict liability standard without regard to the state of mind or level of care of an entity or its officers, as existed under Australia's pre-2020 disclosure regime, is not appropriate in light of the complexities and challenges faced by entities in seeking to comply with their continuous disclosure obligations.

Instead, in order to be most effective, the regime must strike an appropriate balance between the competing policy demands of the timely disclosure of material information and ensuring only reasonable and appropriate regulatory burdens are placed on market participants.

The fault element introduced by the 2021 Amendments largely addresses these issues and has gone a long way towards restoring a more appropriate balance between these policy demands, by continuing to maintain a high bar for continuous disclosure while easing the regulatory burden placed on market participants.

3.2 Declining class action levels

At least 53 class actions were filed during the 2022/2023 financial year. This is the lowest total since the 2016/2017 financial year, during which only 36 class actions were filed. There has been a decrease in number of class actions filed in each of the financial years since the 2021 Amendments were first introduced in the second half of 2020, with 65 class actions filed in 2020/2021, 56 filed in 2021/2022 and 53 filed in 2022/2023.[6]

While it is difficult to prove a direct causal link, we believe that the 2021 Amendments have played a role in this outcome.

3.3 Reductions in D&O premia

The cost of class actions to policy holders and D&O insurers in Australia remains significant. Defence costs for a shareholder class action are typically in the region of $15-$20 million, though may be even more if the relevant burden of discovery is higher than usual.[7] In some cases, particularly where a significant deductible applies, these costs will be borne almost entirely by policyholders. Settlements remain at an average value of around $60 million.[8]

We are aware of significant premium reductions having been offered in the D&O market following the introduction of the 2021 Amendments (with these reductions typically being in the range of 20-30% but going up to as much as 50% in some cases), along with opportunities for reduced deductibles (albeit, with consequences for premia).

Again, while it is difficult to prove a direct causal link, we believe that the 2021 Amendments have played a role in this outcome.

3.4 Continuous disclosure decision-making

[5] Josh Frydenberg, 'Reforms to Australia's Continuous Disclosure Laws Pass Parliament' (Media Release, Department of the Treasury, Commonwealth of Australia, 10 August 2021); Michael J Duffy, 'Modifications to Continuous Disclosure Requirements and the Role of Corporate Knowledge, Intent, Recklessness and Negligence in Breaches: A Discussion' (2021) 38 *Company and Securities Law Journal* 138, 139.

[6] King & Wood Mallesons, *The Review: Class Actions in Australia 2022/2023* (11 October 2023) 4.

[7] Peter Cashman and Amelia Simpson, Submission to Department of the Treasury (Cth), *Parliamentary Joint Committee on Corporations and Financial Services on litigation funding and the regulation of the class action industry* (26 October 2020).

[8] Business Council of Australia, Submission to Department of Treasury (Cth), *Parliamentary Joint Committee on Corporations and Financial Services on litigation funding and the regulation of the class action industry* (June 2020).

At the time that the 2021 Amendments were being considered, there were concerns that their introduction would result in a reduction in the level of seriousness that directors and boards would afford to their decision-making around continuous disclosures and related issues.

We have not seen any diminution in the seriousness with which directors and boards of listed entities have approached their continuous disclosure decision-making during the period following the introduction of the 2021 Amendments.

In our experience, directors and boards have continued to be as vigilant as ever in their continuous disclosure decision-making and have maintained the same level of regard toward their continuous disclosure obligations.

3.5 Reporting regime on climate-related financial disclosure

In December 2022 and June 2023, the Federal Government conducted consultations on the proposed reporting regime on climate-related financial disclosure. One aspect of the proposed regime which has caused some concern among our clients is the limited protection available to companies in relation to forward-looking statements made in accordance with the mandatory reporting on climate transition planning and target setting.

While Herbert Smith Freehills' submission[9] on the first consultation stated that the proposed limitation on liability under the regime is inadequate, Treasury did not accept this position. The second consultation paper, in June 2023, stated that the operation of the existing continuous disclosure laws (including the 2021 Amendments) provided sufficient protections for companies on the basis that the "additional fault element that requires knowledge, recklessness or negligence… results in a requirement for a higher threshold to be proven before liability can be attached and should raise the threshold for class action cases".[10]

As such, in our view, any repeal of the 2021 Amendments would be at odds with this position and, accordingly, the Federal Government would need to re-consider its position on liability for companies required to comply with the proposed climate reporting regime.

4 Conclusion

Australia's continuous disclosure regime plays an important role in Australia's capital markets. The regime has developed over decades, with some of the most important reforms being made recently, through the 2021 Amendments. The 2021 Amendments help the regime to strike an appropriate balance between the competing policy demands of the timely disclosure of material information and ensuring only reasonable and appropriate regulatory burdens are placed on market participants.

In our view, the 2021 Amendments have had a positive impact on the Australian continuous disclosure regime. As such, we strongly support their retention.

We are grateful that Treasury has provided us with the opportunity to make submissions on this important topic. We would be pleased to discuss any aspect of this submission with Treasury if that would be helpful. Our contact details are set out below.

Yours sincerely

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Tony Damian
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[9] Herbert Smith Freehills, Submission to Department of the Treasury (Cth), *Climate-Related Financial Disclosure* (24 February 2023).

[10] Department of the Treasury (Cth), *Climate-Related Financial Disclosure* (Consultation Paper, June 2023) 31.