Dealing with continuous disclosure in COVID-19 environment

AICD proposal for a temporary safe harbour – revised, 7 April

Overview of proposal

- The COVID-19 crisis has caused extreme market volatility and ongoing uncertainty. This poses particular challenges for boards and companies required to comply with continuous disclosure and misleading and deceptive conduct laws that are amongst the strictest in the world. It also creates a materially heightened risk of opportunistic securities class actions led by litigation funders.

- Of particular note:

    - providing earnings guidance and general forward-looking information about company performance that will not fall foul of the law has become very difficult given the uncertainty facing companies and the broader economy. It is also a preoccupation for boards at a time when their focus must be on business continuity and crisis management; and

    - the circumstances generate a significant risk of opportunistic securities class actions, creating another significant board and company distraction in the current environment.

- The AICD proposes a targeted solution that is directed at the specific disclosure challenges presented by COVID-19. In brief, we are proposing that the Corporations Act be amended via the Treasurer's new power to provide that, so long as disclosure decisions are made in good faith, only the Australian Securities & Investments Commission (**ASIC**) can take action against listed disclosing entities or their directors or officers in relation to earnings guidance or forward-looking statements about company performance made in the context of the COVID-19 pandemic. This would complement the existing powers the ASX has to take enforcement action in response to deficient disclosure. Detail on policy considerations and proposed wording for the amendment are below.

Policy considerations

- This amendment is targeted at recognising the challenges associated with giving earnings guidance and forecasts in the current environment of extreme volatility and uncertainty. Given the pace of change that companies are currently facing, it is difficult for them to understand and forecast the impact of COVID-19 both on the individual entity and the wider economy, as well as the duration of that impact and when the 'peak' of the disruption may occur.

- This uncertainty creates a material securities class action risk given the attractiveness of the Australian class actions market to third party litigation funders (including because of the ease of bringing a case, strictness of laws to be complied with, and availability of funding capital) and the upward trend in securities class actions (currently around 45% of all securities class actions ever initiated in Australia are in the pipeline). This trend has led to major increases in D&O

insurance premiums over the last 18 months, prompting the current crisis in that insurance market. Currently, the ALRC estimates that around 50c in the dollar of any securities class action settlement goes to lawyers and funders.

- Notably, there is no due diligence defence currently available to listed entities. The continuous disclosure requirement is strict in that liability will attach to the failure to disclose without the need to establish a requisite fault element. The ALRC's final report on class action proceedings and third party litigation funders queried whether the interests of justice are being served by the current settings.

- The proposed amendment is intended to be a focused solution that is directly tied to the current pandemic and the threat of opportunistic litigation, so will not lead to long-term disruption to the continuous disclosure regime or undermine Australia's system for ensuring market integrity. It would also not cover every COVID-19 related disclosure.

- Companies will still need to disclose where they have actual figures or information to update the market with – for example, in relation to debt covenants, the loss of a material contract, or material changes to their workforce. Further, any disclosure decisions about forward looking information that do fall into the safe harbour would need to have been made in good faith.

- The ASX has released welcome guidance with respect to the application of the continuous disclosure rule in light of COVID-19, acknowledging that a listed entity's continuous disclosure obligations 'do not extend to predicting the unpredictable' and emphasising that information that comprises matters of supposition or that is insufficiently definite to warrant disclosure does not need to be disclosed. ASX has also encouraged entities to review their published guidance in light of COVID-19 and to either update it if it was not current or withdraw it.

- However, the ASX guidance is only a short-term fix. Given the inherently uncertain nature of the pandemic, there is a real risk of a longer-term information vacuum for investors which would not be in the interests of market participants or the broader economy.

- Moreover, despite the uncertainty, some analysts are already updating company reports and forecasts. This may create situations where boards and companies:

    - may feel compelled to respond despite internal forecasts not having been sufficiently settled; or

    - become legally compelled to correct market consensus despite not wishing to provide earnings guidance given the inherent uncertainty,

  which creates a real risk of opportunistic litigation launched with the benefit of hindsight.

- Our proposal will give boards greater comfort to be able to provide forecasts and updates to the market where possible, with appropriate protection from liability to recognise the unprecedented market conditions. This is a better policy outcome than simply advising all companies to withdraw all guidance to the market, as the company will typically be best positioned to provide information to the market and ensure trading is occurring on an informed basis. The proposal would simply ensure that bona fide efforts from companies and their officers to inform the market are appropriately protected from subsequent securities class actions.

- The suggested amendment would, in effect, prevent securities class actions arising out of a breach of continuous disclosure obligations or misleading and deceptive conduct in relation to

earnings guidance and forward-looking statements connected to COVID-19. Securities class actions could still be brought in relation to breaches of continuous disclosure obligations or misleading or deceptive conduct connected to any materially price sensitive information that is not forward looking.

- Barring securities class actions in relation to these matters, but maintaining the ability of ASIC to bring an action in appropriate circumstances, would reflect a deliberate policy choice to reduce the burden of opportunistic litigation at a very sensitive time while balancing the need for accountability and redress. ASIC has acknowledged the difficult judgment calls that can be involved in compliance with disclosure obligations, and will consider the regulatory benefits and public interest in bringing a case. ASIC could also provide guidance on the way it which it intends to regulate disclosure in the current COVID-19 environment, thereby providing some comfort to organisations grappling with very difficult disclosure judgements.

- There is additional regulatory protection from the ASX, which is monitoring statements by listed entities for misleading claims about COVID-19 and has emphasised that it is prepared to suspend trading or censure companies making misleading statements.

- Notably, directors and officers would still need to comply with core statutory and general law duties, including the duty to act with care and diligence, which can carry with them civil, and at time, criminal liability. Any defective disclosures (including in relation to earnings guidance or other forward-looking statements) may result in a breach of the duty of care and diligence, and there are numerous examples of directors being pursued by ASIC for alleged disclosure failures.

- The proposed amendment is similar to other key jurisdictions' usual approaches to regulating forward looking statements. Notably, under safe harbour defences in the US and Canada , liability can be excluded in specified circumstances where the forward-looking statement is identified as such and accompanied by proximate cautionary statements. Under our proposal, however, the regulator would still be able to take action in appropriate circumstances.

- Our proposed Corporations Act amendment for consideration is outlined below, along with some FAQs which clarify the scope of our proposed measure (see Appendix).

Safe harbour for statements arising from the COVID-19 pandemic

[xx] No claim or proceeding can be commenced against a listed disclosing entity, its officers or any other person, under Commonwealth, State or Territory laws or under the common law in relation to:

1) a failure to make, withdraw, correct or update:

   a) earnings guidance: or

   b) any forward looking statement;

   regarding the impact of the coronavirus known as COVID-19 on earnings or company performance; or

2) any earnings guidance or other forward-looking statement made regarding the impact of the coronavirus known as COVID-19 on earnings or company performance,

other than a claim or proceeding commenced by ASIC.

Appendix: FAQs regarding temporary safe harbour proposal

Why do we need this safe harbour?

- Currently, it is difficult - if not impossible - to precisely forecast the impact of COVID-19 both on the individual entity and the wider economy, as well as the duration of that impact. ASX itself acknowledges it is a 'rapidly evolving and highly uncertain situation'.
- The Government has already made reforms to insolvent trading laws to recognise that these are uncertain and unprecedented times. We want Boards and executives focussed on managing their businesses through the downturn. Boards should not be focused on compliance at the expense of financial sustainability and survival.
- The safe harbour will facilitate better information flow to the market, while recognising the extraordinary and volatile market environment companies are currently operating in. Investors have told us that the ASX guidance risks a vacuum of information.

Won't this encourage directors to make statements that they aren't certain about?

- Securities class actions are launched with the benefit of hindsight. Even in normal circumstances, disclosure decisions can be devilishly tricky. Analysts are already updating company reports and forecasts. In the context of COVID-19, boards and companies will be faced with the prospect of monitoring and potentially correcting market consensus even as they face unprecedented difficulties with their own internal forecasting.
- Withdrawing all earnings guidance is a short-term fix and could ultimately lead to an information vacuum for investors, which is a far worse outcome for the market. We want to facilitate disclosures made in good faith based on reasonable grounds.
- Ultimately, boards will not be able to avoid making forward-looking statements as analysts begin to make forecasts as to company performance. ASX itself has stated that a failure to correct or update the market could breach Listing Rule 3.1 or section 674 of the Corporations Act) (see Guidance Note 8).

What if a company that gave earnings guidance several months ago, before coronavirus, still doesn't update it? Won't people assume that coronavirus hasn't impacted them?

- The safe harbour doesn't change the operation of the law. Companies and directors must still comply with the continuous disclosure obligations and misleading and deceptive laws. Directors also have duties under statute and general law, including the duty to act with care and diligence.
- While the safe harbour would protect a failure to withdraw guidance, it would only apply where the decision had been taken in good faith. It also wouldn't prevent the ASX or ASIC taking action against a company or officers involved in the contravention.
- The safe harbour would ***not*** protect any market sensitive information that is not forward looking – such as information relating to material changes in business fundamentals; workforce issues; impacts on material contracts and operational impacts. In other words – if a company knows for

certain that they have lost a material contract, this will need to be disclosed to the market. The safe harbour would not protect such disclosures from liability.

How would the Centro case be decided if the safe harbour were in operation?

- Centro turned around the misclassification of liabilities in accounts. That's not something that would be protected by our safe harbour, which is focused on the impact of COVID-19.
- It's also worth emphasising that the safe harbour is targeted and only covers specific types of disclosures that are particularly difficult for companies and directors to make in the current environment – that is, statements that look ahead and try to predict what their earnings could be in the coming period.
- Even with the safe harbour, directors would still be subject to duties under the Corporations Act and common law, including to take due care and diligence and act in good faith and in the best interests of the company. So it's not the case that they wouldn't come under scrutiny.

Won't this encourage companies to make dodgy and unfounded disclosures?

- No. We want to facilitate information flow to the market and give directors and companies the confidence to make good quality, good faith disclosures.
- Directors won't have a free pass to make dodgy disclosures. Under our safe harbour, directors would still be subject to duties under the Corporations Act and common law, including to take due care and diligence and act in good faith and in the best interests of the company. So all disclosures would still need to be made in good faith and wildly unfounded claims would not be protected.
- Companies still need to disclose where they have actual figures or information to update the market with (for example, in relation to debt covenants, material contracts, or workforce issues). Our safe harbour is targeted at earnings guidance and forward-looking statements only, and only in relation to the impact of COVID-19.
- ASIC as the market regulator has the principal responsibility for the legal enforcement of disclosure laws. ASX has already said that it will be closely watching disclosures in a COVID-19 environment and taking action where necessary (for example suspending trading).

Aren't you removing a fundamental investor protection and right by preventing class actions?

- The current environment creates a significant risk of opportunistic securities class actions driven by litigation funders making excessive profits. This leads to board and management distraction, which ultimately damages shareholder value.
- Australia needs boards focused on appropriately managing the current economic crisis and retaining employees. They shouldn't have to be worried about class action law firms and litigation funders taking advantage of the crisis to launch actions. According to the ALRC, around half of the proceeds of all class action settlements goes to lawyers and funders, not shareholders.
- We think the safe harbour is aligned with investor interests as it will keep investors better informed and give directors the confidence to update the market.

- ASIC and ASX will still be able to take action, which will give investors comfort that egregious breaches will be pursued by the regulators where appropriate.
- The statutory derivative action also gives individual shareholders (or groups of shareholders through a class action) a means of enforcing directors' duties against directors.

ASX has said that companies should just withdraw their earnings guidance – why isn't this sufficient to address the issue?

- The ASX guidance is helpful, but we don't think it's a long-term solution. It's not viable to simply tell companies not to update the market – this will lead to a vacuum of information, not to mention a potential breach of their continuous disclosure obligations. This cannot persist for the six months or more during which COVID-19 will generate major economic disruption.
- Instead, we'd like to see the ASX facilitating appropriate COVID-19 related disclosures, forecasts and updates to the market where possible. That's what our safe harbour is designed to achieve.
- Ultimately, boards will not be able to avoid making forward-looking statements as analysts begin to make forecasts as to company performance. ASX itself has stated that a failure to correct or update the market could breach Listing Rule 3.1 or section 674 of the Corporations Act) (see Guidance Note 8).
- What our proposal tries to do is to encourage timely, meaningful disclosure by companies by removing the risk that well-intentioned disclosures could be used as the basis for a class action down the track.