24 July 2023

Climate Disclosure Unit
Market Conduct and Digital Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Treasury

Climate related financial disclosure: Second Consultation

1. Thank you for the opportunity to comment on the *Climate-related financial disclosure – Consultation paper* (June 2023) (CP).

2. There are four substantive parts to the CP: reporting entities and phasing; reporting content; reporting framework and assurance; and liability and enforcement. My comments relate to law design issues raised by the parts of the CP dealing with the reporting framework (pp 19 – 22) and liability and enforcement (pp 27 – 28).

3. The CP describes the climate-related financial disclosure (CRFD) proposals at a high level only. I have adopted the same approach, noting that a much more detailed analysis of the technical issues is clearly needed **before** any drafting instructions for legislation are prepared. This should be carried out by specialist lawyers with a deep understanding of the existing disclosure laws. My comments are intended only to alert you to technical areas that require further consideration before settling on the overarching design for the CRFD regime, rather than to provide a detailed explanation of the issues or solutions, or to advocate for a particular outcome.

4. Importantly, the comments that follow are not an argument against, nor a criticism of, the introduction of a mandatory CRFD regime that gives effect to standards consistent with ISSB's IFRS S2 *Climate-related disclosures* (2023). This reform is both appropriate and inevitable. But it is technically very difficult to implement in Australia, because of the parlous state of Australia's existing corporate disclosure laws.

5. The CRFD regime will weave additional mandatory disclosure requirements into an existing legal framework that is already highly technical, unstable, complex, and incoherent. In 2013 my co-author and I described the liability rules for corporate disclosure in Australia as a "dog's breakfast".[1] Unfortunately the situation has worsened since then, including as a result of subsequent reforms to the continuous disclosure laws. For an indication of the current complexity of the law see, for example, Australian Law Reform Commission, *Data Analysis: Disclosure*

[1] Tim Bednall and Pamela Hanrahan, "Officers' liability for mandatory corporate disclosure: Two paths, two destinations?" (2013) 31 *Company and Securities Law Journal* 474, 510.

(March 2021)[2] and Australian Securities and Investments Commission (ASIC) *Information Sheet 278: Inventory of superannuation trustee transparency and disclosure obligations* (April 2023).[3]

6. Any addition or change to the existing legal framework has multiplying flow-on effects that must be very carefully mapped and understood. Otherwise, the reforms may create a liability risk for entities and individuals who are subject to the new law that cannot be properly managed. This will likely result in resistance to the reforms and distort disclosure behaviours in a way that undermines the goals of the reforms. This is a **significant implementation risk for Government**.

7. Formulating new CRFD laws will require three key decisions: (1) what should be disclosed by whom and when; (2) where and in what form that disclosure should be made; and (3) what should be the consequences of inadequate or inaccurate disclosure (that is, defective disclosure). As the following comments show, (2) and (3) are directly related.

Disclosure in the annual report

8. The CP indicates that CRFD will appear in the entity's annual report (p 19). I understand this is the Government's strong preference so my comments assume this approach will be adopted.

9. The first important thing to note is that the annual report is not a single document. It is (currently) comprised of three separate reports: the financial report, the directors' report and the auditor's report. The financial report and the directors' report are subject to different forms of assurance and sign-off. For this reason, it matters where CRFD will appear *within* the annual report.

10. The CP says that "climate disclosure would be required as part of both the directors' report and the financial report". This needs to be unpacked.

11. My understanding is that the prescribed content of the financial report will not change – rather the comment in the CP is intended to reflect the fact that climate-related risks and opportunities (like all other risks and opportunities) that have a material impact on the financial position of the entity will flow into the financial information that appears in the financial report. This is already the law. (If my understanding is not correct, this will require further consultation with auditors.)

12. This is important because the financial report (not the annual report as a whole) is audited and because the directors' declaration (as to true and fair view and compliance with accounting standards) in s 295(4) of the *Corporations Act 2001* (Cth) (*Corporations Act*) goes to the financial report, not the whole annual report. The CEO/CFO assurance letter for listed companies required by *Corporations Act* s 295A also goes to the financial report, not the annual report.

13. As the CP acknowledges, the assurance mechanism that allows for audit of the financial report and underpins the directors' declaration in *Corporations Act* s 295(4) about the financial report is not yet available for CRFD.

14. Therefore, the stand-alone mandatory CRFD (that is, the "reporting content" of the kind described on pp 10 – 18) appears not to belong in the financial report; rather, the financial report is where the impact of climate risk and opportunity on the financial position and performance of the company is disclosed in accordance with existing law and accounting standards. (There may be a time or "end state", after the AASB has completed the standards work described on p 10 and the assurance mechanisms described on pp 22 – 26 are in place, when boards could be asked to make a declaration about adherence to the new AASB standards in relation to CRFD, but we are not there yet.)

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[2] Available at https://www.alrc.gov.au/inquiry/review-of-the-legislative-framework-for-corporations-and-financial-services-regulation/data-analysis/disclosure/.

[3] Available at https://asic.gov.au/regulatory-resources/superannuation-funds/superannuation-guidance-relief-and-legislative-instruments/inventory-of-superannuation-trustee-transparency-and-disclosure-obligations/.

15. So, my understanding is that the mandatory CRFD described on pp 10 – 18 will likely appear in the entity's annual report as part of the directors' report (but see paragraph 17).

16. The directors' report is not covered by the directors' declaration in *Corporations Act* s 295(4), which declaration is made by resolution of the board under s 295(5). Instead, the directors' report is made under a different board resolution (to different effect) under *Corporations Act* s 298(2). This is a very important distinction.

17. From a design point of view, it is open to Government to require an entity include this mandated CRFD in either the directors' report or in a separate part of the annual report called the climate report. An example of the former approach is the remuneration report for listed entities provided as part of the directors' report under *Corporations Act* s 300A. The latter approach would mean the annual report comprises four parts rather than three. I understand that the latter approach – putting CRFD in a separate stand-alone fourth part of the annual report with a separate directors' resolution adopting it – is not Government's preferred option. But it may help with the readability problems discussed on pp 19 – 20 and make it easier to implement either the "modified liability approach" discussed on p 27 or another agreed transitional arrangement in relation to administrative, civil, or civil penalty liability for defective disclosure.

18. As it is part of the annual report, the CRFD will speak as at the date of the relevant directors' resolution. And, as with the rest of the annual report, it would not be updated throughout the year. I understand that it is not intended that CRFD will be required in the half-year directors' report given under *Corporations Act* s 306. That said, if a disclosing entity becomes aware of subsequent or corrective information on any topic that requires disclosure under the continuous disclosure rules (see paragraph 21 below) that must be provided to the market in the ordinary course. Remember that subsequent or corrective information must be disclosed under those rules only if it is price-sensitive – this is different from the concept of materiality for periodic disclosure mentioned on p 11.

19. The remarks in the CP under the heading "Existing annual report requirements" on p 19 do not accurately convey the current legal requirements relating to annual reports. Remember the directors' report is not audited and is not covered by the declaration made under *Corporations Act* s 295(4). Also, while *Corporations Act* s 180 is relevant to the preparation of the annual report, *Corporations Act* ss 344, 1308 and 1309 (which include civil penalty provisions) are much more important sources of liability for the entity and its officers and employees in this context.

Continuous disclosure and fundraising

20. The CP says on p 21 that "climate-related disclosure obligations would extend to continuous disclosure and fundraising document obligations". It is not yet clear what is intended.

21. I understand that is it not proposed to alter the text of the continuous disclosure laws (see p 28). If so, the statement on p 21 may simply reflect the existing legal requirement that any price-sensitive information – including climate-related information – must be disclosed if and when disclosure is required under *Corporations Act* ch 6CA.[4] It may be helpful for ASX to update *Guidance Note 8* to make it clear when developments touching on CRFD are likely to be price-sensitive and trigger the disclosure obligation. ASIC may wish to issue similar guidance for unlisted disclosing entities.

22. As for fundraising documents, this is a very complex area.[5] The content requirements and liability settings for different types of fundraising documents are highly specific and non-intuitive. There are fundamental differences between fundraising under the securities law in ch 6D of the *Corporations Act* ch 6D and the financial product law in *Corporations Act* pt 7.9. The latter

[4] See A Black and P Hanrahan, *Securities and Financial Services Law* (10th ed, LexisNexis, 2021) Ch 6, 7 and 8.
[5] Ibid, Ch 4, 5, 7 and 8.

applies to many significant entities, including listed and unlisted trusts and all superannuation funds. Even in the securities world, it is untrue that "prospectuses are the most common type of fundraising disclosure document".

23. A fundamental law design question is whether the content requirements for different types of fundraising documents will be amended to specifically require CRFD, or whether there is an expectation that CRFD will be provided under the general disclosure tests that prescribe the contents of these documents. Will *Corporations Act* pt 6D.2 div 4 or pt 7.9 div 2 subdiv C (and all the legislative instruments that modify them) be amended? Note that the general disclosure obligations are different as between the two disclosure regimes; for example, the former includes a due diligence requirement.

24. This design choice has significant liability implications because the liability settings for defective disclosure in and between fundraising laws are not the same as the liability settings for defective disclosure in annual reports or other statements (including voluntary statements) made by an entity.

25. Unlike an annual report which is a point-in-time document (see paragraph 18) a fundraising disclosure document must be updated for material changes during the whole of the offer period (see e.g. *Corporations Act* ss 719 and 730). This includes for offerors continuously in the market, such as superannuation funds (see *Corporations Act* pt 7.9 div 2 subdiv C and D).

Liability and enforcement

26. The discussion on pp 27 – 28 of the CP does not engage fully with the existing liability settings for corporate disclosure. Broadly speaking, these settings will determine the liability of entities and their officers where the entity makes defective disclosure.

27. The existing liability settings for corporate disclosure are different depending on the context in which the disclosure failure occurs – for example, in an annual report, a disclosure document under *Corporations Act* ch 6D, a disclosure document under *Corporations Act* pt 7.9, as voluntary non-statutory disclosure (for example, on a website or in an advertisement) or as part of continuous disclosure compliance under *Corporations Act* ch 6CA. Numerous overlapping (and sometimes inconsistent) liability rules apply. These cover administrative, civil, civil penalty and criminal consequences. Some of the disclosure regimes purport to carve-out liability under the general (civil) misleading conduct provisions in *Corporations Act* s 1041H and the *Australian Securities and Investments Commission Act 2001* (Cth) (*ASIC Act*) s 12DA in full or part; others do not. The specific operation of each liability provision as it applies in each context must be individually considered.

28. The proposal on p 27 of the CP addresses potential civil penalty liability and civil liability for defective disclosure.

29. The difficulties for Australian entities being required by law to make forward-looking statements are real, given the reverse evidential burden created by the current misleading conduct laws. This was the subject of submissions to Treasury in the first consultation which I will not repeat here.

Civil penalty provisions

30. Page 27 of the CP states that CRFD "would be drafted as civil penalty provisions in the Corporations Act" (p 27). However, if CRFD is to be woven into existing disclosure requirements (annual reports, prospectuses etc) then, presumably, existing civil penalty settings for those forms of disclosure would apply. These settings are different as between different forms of disclosure. (For example, there is no civil penalty provision for annual reports that corresponds to *Corporations Act* s 728(4), nor should there be.)

31. Depending on the context, defective CRFD in mandatory corporate disclosure could potentially enliven existing civil penalty provisions that include *Corporations Act* ss 344(1), 674A(2) and (3), 675A(2) and (3), 728(4), 912A(5A), 1021E(8), 1308(4) and (5), and 1309(12). Defective disclosure, including voluntary disclosure, may also enliven *ASIC Act* civil penalty provisions like ss 12DB and 12DF, with associated compensation rights under s 12GF and the capacity of ASIC to use its infringement notice power under *ASIC Act* s 12GX. Each of these sections takes a different approach to determining whether, and in what circumstances, defective disclosure should amount to a contravention of a civil penalty provision and by whom, and what the consequences (including regulatory action with or without a monetary penalty or a civil claim by affected stakeholders) should be.

32. Some of the applicable *Corporations Act* civil penalty provisions mentioned in paragraph 31 are classified as corporation/scheme civil penalty provisions, some are financial services civil penalty provisions, and some are uncategorised – this affects questions of standing and access to compensation by way of private proceedings (see *Corporations Act* ss 1317H, 1317HA and 1317J).

33. All these civil penalty provisions carry the potential for attempt or involvement liability (see *Corporations Act* s 1317E(4) and *ASIC Act* s 12GBCL). Some have a fault element built into the contravention, and others do not (see *Corporations Act* s 1317QB and *ASIC Act* s 12GBCN). For example, defective CRFD in a prospectus would give rise to civil penalty liability under *Corporations Act* s 728(4) regardless of fault and the defences in ss 731 – 733 do not apply.

34. The disclosure-related civil penalty provisions identified in paragraph 31 operate alongside directors' and officers' duties in *Corporations Act* s 180, 601FD and 1224D and *Superannuation Industry (Supervision) Act (1993)* (Cth) s 52A, breach of which in connection with corporate disclosure can result in direct civil penalty liability for the individuals involved.

35. It is worth noting that private parties, not just ASIC, can bring civil proceedings based on contraventions of civil penalty provisions. This fact is sometimes missed. Only ASIC can ask for a declaration of contravention or a civil penalty order under *Corporations Act* pt 9.4B because of s 1317J but private claimants have other remedies, including declaratory remedies: see eg *Macks v Viscariello* [2017] SASCFC 172.

Relief by Courts

36. It is wrong to think, as stated on p 27 of the CP, that entities or their officers can expect to be relieved of liability under *Corporations Act* ss 1317S or 1318 if they contravene the law in relation to corporate disclosure, or that the possibility of relief affects a regulator's decision to bring proceedings. This is not how the law works in practice. If the Parliament passes a law that evidences an intention to apply a penalty or consequence to a person in circumstances not involving fault on their part, Courts will respect that. This is particularly so in civil penalty proceedings, where general deterrence is a factor to be taken into account: see e.g. *ASIC v Healey (No 2)* (2011) 196 FCR 291.[6]

37. In any event, the relief is not a defence – it is available only after the person is found to have contravened the law by a Court. If a general defence (for example, of reasonable steps to ensure compliance) is envisaged, it should be included in the legislation.

Infringement notices

38. The CP also says that "infringement notices will be available for breaches". In my view the use of infringement notices should not be extended in this way. (Respectfully, this comment extends to

[6] This is discussed in P Hanrahan, *Directors' Legal Responsibilities: A Handbook for Australian Boards* (AICD, 2022) at [12.6], where I refer to it as a "Hail Mary pass".

the current use by ASIC of infringement notices under *ASIC Act* s 12GX in connection with corporate disclosure failures.) In this I echo the Law Council of Australia's long-standing and principled objection to the use of infringement notices for matters involving the exercise of judgment on the part of a regulated person, for reasons previously shared with Treasury.

Modified liability

39. I make no comment on the adequacy of the "modified liability approach" and whether it goes far enough by restricting enforcement (civil and civil penalty) to the regulator for specified parts of CRFD for a fixed time, other than to say that in my view a more staged approach (allowing entities time to get disclosure right first) may be more likely to produce meaningful and concise disclosure in the medium term.

40. In developing the new CRFD law, it would be helpful for Treasury to reflect on the liability settings for mandatory corporate disclosures (especially qualitative disclosures) that apply in other comparable jurisdictions. There is no need for Australia to be an outlier on this issue.

41. I do note that the proposed "modified liability approach" is technically complex to implement. The proposal on p 27 is for regulator-only enforcement of misleading and deceptive conduct laws in relation to specified parts of the CRFD for three years. If this policy is adopted, care must be taken to "switch-off" all relevant enforcement pathways for private claimants based on defective disclosure, including through the civil penalty regime where it creates private remedies (see paragraph 35) and under other statutory civil remedies such as *Corporations Act* ss 729, 793C, 1022B, s 1041I, 1101B, 1324 and 1325 and *ASIC Act* s 12GF

42. If you would like to discuss these issues further, please let me know.

Yours faithfully

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